Architect's Essentials of Starting a Design Firm

Peter Piven, FAIA

Bradford Perkins, FAIA, OAA, AICP

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To Alf Werolin and Weld Coxe, who taught each of us to be effective advisers to others

To Lawrence Perkins, who passed on his wisdom and experience about starting a firm

and

To our wives, Phyllis Friedman Perkins and Caroline Piven, who supported us with this project even when it got in the way of family obligations

Contents

Introduction

So you're thinking about starting your own design firm. You are not the first to have this desire, nor will you be the last. It is a common dream for many—if not most—design professionals. In fact, hundreds of design professionals start new firms each year for various reasons, and many others plan for the day when they can take the same initiative. Some start their own firms because they want to pursue their own ideas and interests, others because they see it as an opportunity to make a better living, and still others because they do not want to work for someone else. For each individual, there are different factors that lead to this common dream.

This book was written to help those who have this dream decide whether, and when, to start their firm, as well as to guide them through the steps necessary to achieve a successful launch and get them through the challenging first years of operation. As in any field, a significant number of new design firms never get off the ground or achieve the founders' major goals. But for many professionals, having their own firm is a satisfying, challenging, and rewarding experience.

There is no one formula to follow to guarantee success, but most founders of new firms who achieve their goals observe the basics of creating a successful practice. One of the most important basics is to have a plan. This book was written for design professionals (including architects, engineers, graphic designers, interior designers, landscape architects, and others involved in planning and designing the built environment) who are considering starting, or have already started, a new firm. Most of the material is also relevant to smaller design firms whose founders are interested in growing and/or changing their current practice. It focuses on the basic financial, marketing, and other necessary tools and puts them all within the framework of a plan for operating the new firm.

Most of the examples used in the book are drawn from firsthand experience and are relevant to the issues facing any design professional building a new or working in a small firm. Some of this material was first developed to support a course on the same topic given by the two of us each summer at the Harvard Graduate School of Design, but the bulk of the book is based on our personal experience as principals of architectural firms and as advisors to others in the field.

This book is organized into 11 chapters and 2 appendices:

- Chapter 1 discusses the motivations and analysis that often precede the startup of a new firm. Most design professionals have some, but not all, of the skills, capabilities, and resources needed to start and build a successful practice. For some this means they should consider a career in an existing firm. For others, this initial

analysis helps clarify why having their own firm is important and identifies what steps—such as finding partners with complementary capabilities—they must take to have a realistic chance of success.

- Chapter 2 addresses the essential task of obtaining clients. Without a steady flow of new work, any design firm will fail. All successful firms find a way to achieve this essential goal, and most of the techniques they use can be learned. To that end, the first part of the chapter discusses the strategic techniques involved in establishing a marketing plan; the second part outlines some of the most important tactical aspects of a successful sales program.
- Chapter 3 explains the financial management of a design practice. It does not try to teach design professionals how to be accountants, but it does describe the basic tools and techniques used to plan, build, and guide the financial health of a young design firm.
- Chapter 4 investigates two of the most challenging tasks faced by even the most experienced heads of successful firms: setting fees and negotiating contracts.
- Chapter 5 introduces some of the central organizational and personnel management tools and options that a young firm should consider.
- Chapter 6 outlines some of the legal and ethical basics that should be considered.
- Chapter 7 lists a number of the available resources that will help a new firm both in its early years and once it has become established.

- Chapter 8 coordinates the material presented in the first seven chapters and describes how these techniques can be used to create a comprehensive plan for your firm's future.
- Chapter 9 confronts one aspect that should be—but rarely is—included in the firm's plan: a structured approach to achieving design excellence.
- Chapter 10 provides some cautionary advice for avoiding pitfalls of starting a new firm.
- Chapter 11 outlines the major first steps in launching your firm.
- Appendices include a Study Guide that contains a number of supplemental projects intended for use by both readers and schools, the latter of which may choose to incorporate this material in their practice courses. Appendix B, "Charting Your Course," provides a widely recognized guide to understanding how firms can be organized and managed.

Even for someone with a great deal of self-confidence, starting a new design firm is a daunting task. This book and the techniques and examples it contains are intended to make the task seem less overwhelming. As you read, keep in mind that the firms that you admire and consider successful today were once fragile start-ups. They launched, survived, and then prospered, and so can you.

1 Deciding to "Go on Your Own"

As stated in the Introduction, having their own practice is the goal of many design professionals. A new firm that is successful and achieves its founders' basic goals can be a very satisfying way to pursue a career in the field. But while the rewards (in self-expression, if not income) can be significant, so too can the risks. Most new businesses—whether architectural, engineering, and interior design firms or restaurants—never get off the ground. Some manage to launch and survive, but never really achieve much more than a modest success. A few, however, manage to surmount the inherent problems and achieve success as a business, as well as become what most professionals hope for: a respected firm that is both professionally and financially successful.

Have a Good Reason for Starting Your Own Firm

Assuming you are considering "going on your own" (otherwise why would you be reading this book), the first question to ask yourself is: Why do you think that having your own firm is the right thing for you?

We have spoken to hundreds of people who have started their own firms and no two cite exactly the same motivations. Nevertheless, we've found the answers can be placed into 10 categories, which share a central theme: the desire for greater control over one's future. These categories are:

1. Ability to realize one's own goals and follow one's own interests.
2. Greater ability to balance one's personal and professional lives.
3. More direct relationship between effort and recognition for one's professional accomplishments.
4. More direct relationship between effort and financial reward (the opportunity to make more money than is possible as an employee of someone else).
5. Greater control over one's own destiny, design, and other issues of personal importance.
6. Survival during bad economic times.
7. Satisfaction of building one's own practice.
8. Ability to be involved in everything.
9. Failure to "fit" into an established organization.
10. Desire to work with friends, a spouse, or others of one's own choosing.

It's important to point out that in some ways the concept of greater control is illusory because the founder of a new firm soon finds out that he or she has exchanged the control by a boss for the pressures exerted by demanding clients, making payroll, and carrying out the greater range of tasks expected of the head of even a small firm. Nevertheless, when you have your own firm and face these issues, you usu-

ally feel that you are in control because they are yours to deal with.

The new pressures on the individual starting his or her own firm, however, are usually more than balanced by the benefits of one—or all—of the reasons listed for starting a firm. Few people who have started their own firm and reached the point at which its survival is no longer in question would ever go back to working for someone else.

Having a strong reason to go out on your own is a prerequisite, because the risks, effort, and initial financial investment can be significant. Without a strong reason, most design professionals decide that they are better off having a career within an existing organization. Your reason might be as simple as the prospect of having one or two interesting clients that could help launch a practice or, as for Thom Mayne of Morphosis, it can be recognizing that your personality and work habits are ill-suited to a large corporate practice. As Mayne put it, there was "no other way." The point is, not everyone is cut out to run his or her own firm, but if you feel you have compelling reasons for doing so, there are a number of steps to take before you make the final decision:

1. Be clear as to why you are doing it.
2. Define the type of firm you want to have.
3. Set goals for the first year and for the long term.
4. Look at successful models and research how they succeeded.
5. Define what special services or abilities you will offer that potential clients need.
6. Decide if you have all the basic capabilities necessary to succeed, or if you will need partners and/or colleagues.

7. Decide how you will support yourself until the firm is generating an adequate income to pay you.

Know the Type of Firm You Want

Part of your motivation should be that you have a specific concept of the type of firm you wants to launch. David Grumman began his successful mechanical engineering firm, Grumman/Butkus Associates, in 1973, because he wanted to work directly for owners involved in the rapidly emerging energy conservation arena. He explained, "I wanted to have a different kind of consulting firm, and I did not want to work for architects."

It is not enough to just hang out a shingle that says "architect," "engineer," or "interior designer," and announce, "Hello world, here I am!" It is very important to define what your practice will offer, why it is special or unique, and why people should hire you. The answers to these questions may evolve over time as the firm matures, but it is important to have clear answers in your own mind from day one.

One way to help clarify what you want your firm to be is to define goals that will help measure progress or success. In the first year, some of the goals can be pretty basic, for example:

- To survive.
- To successfully complete three or four assignments.
- To secure enough work for the next year.

Even though it may seem impossible to set goals for 7 to 10 years out (the minimum time it takes most firms to mature from a start-up to an established

firm), the exercise can help establish priorities for your efforts.

If, for example, your goal is to have a practice that is considered a leader in three or four building types, this should help focus your marketing and other efforts of the early years. Or if your goal is to run a firm of choice for a wide variety of assignments in a particular community, this will focus your efforts in a different way. (These choices are discussed in more detail in Chapter 2.)

Firm Types

Every firm is the result of its people and its circumstances, so in that sense each firm is unique. It is possible, however, to develop a general understanding of design firm typologies so that you can make an informed choice about the type of firm you want.

Two key driving forces shape the operation, management, and organization of every architecture firm:

- Choice of technology, defined as the system or process the firm employs to do its work
- Collective values of the firm's principals

Technology shapes the firm's delivery process. Examination of the marketplace reveals three major categories of design firm technologies:

- *Strong-idea* firms, which are organized to deliver singular expertise or innovation on unique projects
- *Strong-service* firms, which are organized to deliver experience and reliability, especially on complex assignments
- *Strong-delivery* firms, which are organized to provide highly efficient service on similar or more routine assignments

Values shape management styles. *Practice-centered* professionals, who see their calling as a way of life, typically have as their major goal the opportunity to serve others and produce examples of their discipline. Their bottom line is qualitative: How do we feel about what we are doing? How did the job come out? *Business-centered* professionals, who practice their calling as a means of livelihood, more likely have as their personal objective a quantitative bottom line that is more focused on the tangible rewards of their efforts: How did we do? (A further explanation of this typology can be found in Appendix B.)

Model Types

In clarifying the type of firm you want to have, and defining a path to get there, it can be very helpful to look at how other firms became successful. Success, of course, should be measured against one's own goals, but for most professionals success includes achieving professional respect, producing interesting work, earning an adequate income, and other basic objectives.

In our experience, 10 common models can be used to launch a successful firm, and there is something to be learned from each. These models are:

1. Major client as "booster rocket"
2. House for mother
3. Academic incubator
4. Better mousetrap
5. Supersalesperson
6. Sponsor
7. Golden handshake
8. Spin-off
9. Rebuild of an existing firm (the phoenix)
10. Starting small in a good market

Some feel that achieving distinction as a successful new design firm is as much about public relations and salesmanship as it is about substance, but generally this is not true. Most design professionals accomplish their goals the old fashioned way: they achieve them by creating a firm with distinctive capabilities and consistently high-quality work. For young firms, achieving success without compromising on other goals (such as making payroll) requires both talent and commitment, especially since they typically must build their practices on a foundation of small projects with limited fees.

Let's review the model types one by one.

Major Client as First-Stage Booster Rocket

The firm is founded or taken beyond the start-up with the support of a single client willing to gamble on a young firm. The combination of the client and the work of the firm acts as a booster rocket that lifts the firm above the crowd to where it can be seen. Most successful firms can trace their success back to one or two important early clients or projects. For architects, a rare variation on this is the firm that wins a major, open competition.

House for Mother

For some new firms, the booster rocket comes in the form of a project for a family member or one completed using family money. Charles Gwathmey, Robert Venturi, and Philip Johnson are only a few examples of well-known architects who became visible thanks to such projects.

Academic Incubator

Many of the best-known, design firm principals have relied on their teaching positions to provide them

with the basic income, time, credibility, and exposure to lay the foundations of a practice. Only when their practice becomes too demanding do they cut their academic ties. Thom Mayne of Morphosis relied on his Southern California Institute of Architecture teaching salary until his practice finally took off.

Finding a Need and Filling It (the Better Mousetrap)

Some firms see an unmet need and set out to fill it. In past years, this has included firms that first focused on specialties, such as recycling historic structures, or smaller projects in communities not served by enough strong local designers, or, currently, sustainable design.

Supersalesperson

A few firms—Kohn Pedersen Fox being one of the best known—got off the ground due in large part to the exceptional sales skills and client relationships of one or more of the founders. All successful architects have some sales skills, but only a handful can convince clients to hire a new firm for major projects over the established competition.

Sponsor

A few firms—among them some of the best known—have had other established professionals act as their booster rockets. This takes various forms. Well-known architects, Charles Moore being the most prolific, have lent their names and skills to young firms. In a few cases, elder statesmen, among them Philip Johnson, promote emerging stars. Philip Johnson's role in winning Michael Graves his first major commission, the Portlandia Building competition, is a well-known example.

Golden Handshake

Sometimes the architect's former employer provides the new firm's initial work. When Brad's grandfather had to leave his position as head of the drafting room of Burnham and Root in the contraction after the 1893 Columbia Exposition, Daniel Burnham helped get him his first commission. A short time after they started, Voorsanger & Mills (later reorganized into two firms, Voorsanger & Associates and Edward I. Mills & Associates) received a major subcontract from I. M. Pei, their former employer, which sustained their start-up.

Spin-off

Among the most common models are the spin-offs—firms that break away from established ones where the new-firm members have built their reputations, skills, and potential client base. In some cases, the spin-offs are led by senior partners of major firms. Kohn Pederson Fox, founded by the former leadership of John Carl Warnecke's New York office; Elkus/Manfredi, founded by a former partner of The Architects Collaborative; and Brennan Beer Gorman, founded by the former leadership of Welton Becket's New York office, are three major examples. More typically, the founders of a new firm spend their early years rising to senior positions below partner level in their former firms, and while there build strong personal reputations and reference lists, as well as a modest base of "moonlight" clients too small for their former employers. Then they break away.

Phoenix

The converse of the spin-off is the takeover. In a few cases, a new young leadership takes over a declining

or moribund existing organization and revives and reshapes it into a new, vibrant firm. Johnson, Fain and Pereira Associates (JFPA, now Johnson Fain) is a well-known example of this model. This model is very complex because—as at JFPA—it involves assuming substantial financial liabilities, an established image, and an established senior organizational structure. Scott Johnson and Bill Fain had to deal with all these while reshaping the design direction of a large practice.

Starting Small

Some firms are content to begin by doing small projects and building on that base. For Tod Williams, Billie Tsien and Associates, a small dormitory at Princeton gave them credibility at an institutional level. After several smaller projects had been published, Princeton included them on a list of alumni architects to be interviewed for what was to be a small addition. Instead, it became a new building, which won several awards and was widely published.

Conclusion

What one learns from the success stories (and sometimes from failures as well) is that most successful firms find a way to define their unique position in the marketplace, to obtain good clients, and to serve these clients well.

On rare occasions, a firm's founder has the right personality, plus all of the requisite skills and capabilities to make a success of a new launch. More often, though, professionals find that an objective self-analysis identifies one or more key gaps in the experience and skills required. This is when it's time to look for a partner or partners. Whether provided

by a single person or a partnership, the two skills that the firm's leadership must provide are the ability to get the work and the ability to do it well. The first of these is the subject of the next chapter; the second is unique to each profession, firm, and individual.

2 Marketing and Sales

To develop a steady or growing volume of interesting projects, all design professionals launching firms have to seek clients and convince them to commission the new firm. Even "over the transom" clients will expect a presentation of previous work before they agree to work with a new firm, and this requires knowing how to market your firm and make project presentations.

Some firms refer to the efforts they make to obtain the clients they want as "business development," which in general can be categorized as *marketing* (the strategic approach to a market) and *sales* (the tactical steps taken to secure clients). This chapter provides an introduction to both of these essential tasks; and the box titled "Elements of a Business Development Program" summarizes them.

Molding a Business Development Program

The importance of a successful business development effort was memorably summarized by H. H. Richardson in response to a wide-eyed mother who implored him one day to advise her son who aspired to be an architect. "What," she asked, "is the most

Elements of a Business Development Program

Markets: Where you will seek work—client base that needs what you have to offer.

Capability: What you offer to the marketplace—the firm's qualifications to serve a market.

Message: What you tell prospective clients— your "distinctive competence" or "distinguishing benefit."

Process and methods: How you will pursue the work.

Marketing organization: Roles and budget.

Image: How you are perceived in the marketplace.

Public relations and promotion: Information that describes and enhances your image

Marketing plan: Documents targets, desired and projected yields, responsibilities and costs.

Marketing: Process of seeking prospective clients.

Sales: Efforts focused on specific prospective clients.

important thing in architectural practice?" "Getting the first job!" Richardson replied, "Of course that is important," she agreed, "but after that what is most important?" "Getting the next job!" was Richardson's gruff response.

As this oft-told story implies, obtaining work is an essential first step for any practice. The *how* of business development is not something that can be taught as a series of tricks and pitches. Professionals are selling a service, not encyclopedias or vacuum cleaners. Each firm has to be extremely creative in developing the approach that is exactly right for it, that is molded to the unique personality of the firm.

The first steps in this molding process are to, one, formulate an internally consistent statement of the firm's goals and, two, conduct an objective analysis of the firm's strengths and weaknesses, as compared

with those of the competition. Certain offices, for example, may want to pursue only prestige projects, the lion's share of which are obtained by what architect Morris Lapidus labeled in his book on building a practice, *Architecture: A Profession and a Business* (Reinhold Publishing Corp., 1967) the "ivory tower" firms. If that is the firm's objective, then the architect must chart a realistic business course that will eventually bring his or her office to a point at which it is the logical choice for these commissions. A firm's members cannot expect to be chosen until they know how much and what type of work they want, as well as how to maximize the strengths and minimize the weaknesses that will affect the firm's selection.

The most important guide in this process is what is known in other businesses as the *marketing concept*. This concept, if it is well developed, can be used effectively not only to help sell professional services but also to improve the quality of the services sold. This concept was defined simply by Henry Kaiser as "finding a need and filling it." All clients have needs, which they expect the architect, engineer, or other design professional they commission to understand and to fill.

Finding a need and filling it is, of course, only one part of a successful marketing and sales program. There are at least 10 other issues that every professional should understand while undertaking their business development efforts:

1. Good projects can (with time, skill and effort) be obtained, but doing so is easiest when you have a plan to begin with.
2. The core of most successful plans is identifying an unmet need and organizing to meet it.

3. No matter how you set out to get work, a thorough understanding of your potential clients' issues, concerns, and specific needs is always important.
4. Your firm's best salespeople are: satisfied clients, third parties with a client's ear, a good image, and a strong reputation for providing the service being sought.
5. Few individuals are natural salespeople. For most, it is a learned skill.
6. Marketing should be continuous, focused, and broadly based—even in a small firm. It's as important to sell when you are busy as when you are slow and think you have the time.
7. Many people have advance knowledge of most potential projects long before the client begins seeking a design professional and it's important to find out who these people are.
8. Each client is important and each early project should be seen as part of the foundation upon which to build the firm's long-term practice.
9. All design professionals should learn basic marketing and sales skills, including doing market research, writing proposals, and making presentations.
10. Some projects are not worth pursuing or doing. Sometimes there are bad projects for good clients. There are no good projects for bad clients.

The Marketing Plan

Twenty years ago, it was unusual to find a design firm that had a formal plan to guide its marketing and sales efforts. Today, a rapidly growing number of professionals have learned that a clear plan can dramatically improve their chances for success.

What is in a typical plan? Most firms that have plans have evolved their own approach, but it typically covers at least the following:

- Understanding of the market
- Analysis of the competition
- Objective view of your strengths
- Objective analysis of your weaknesses
- A plan to continually build strengths and minimize or eliminate weaknesses
- Market research and other techniques to identify and generate leads in the target market
- Outline of the materials that will be needed to support an effective sales process.
- Image-building ideas
- Specific short-term (one-year) and long-term goals

Note: A sample market analysis and plan for a new firm are given at the end of this section.

An essential first step is to understand the market. A "market" in this case means a type of client or project that the firm wants. A market, however, is not synonymous with clients since a single market may include several different types of clients. For one firm, the primary market might be schools; for another, it might be luxury apartments and homes; and for still another, it might be municipal work in a particular region. Many firms are interested in more than one market sector, and in these cases there should be a plan for each.

To understand a market, a design professional should try to learn all he or she can about:

- The clients' primary concerns and issues
- Those with advance knowledge about the project before the selection process begins

- The process the clients typically use to select their design professionals
- References clients call on when choosing professionals
- Trends in project types, volume of work, and so on
- Clients to pursue and clients to avoid
- Prevailing fee levels
- Other complementary (noncompetitive) professional firms serving this market

Addressing Client Concerns

One of the most effective ways to become successful within a market is to attempt to "get inside the potential clients' minds," in order to understand how they perceive what you have to offer. Among the first things to understand is that most clients approach a building program with significant concern and trepidation. They are about to spend a great deal of money on something that they do not really understand. When viewed in this light, you realize that the firm they select will be the one that demonstrates the clearest understanding of their concerns and that provides the evidence that it can and will successfully address every major client issue.

For example, a school board that requires a design for a major addition or renovation will typically want to find a firm or team of firms that:

- Know school planning and design
- Understand how to help sell the need to the community and the design to the state education department
- Will keep the project within budget and on schedule

- Will be able to create an attractive community asset that is a good learning environment for the children
- Are likeable and easy to work with
- Can deal with particular challenges of the project—a tight budget or schedule, a difficult site, and so on

In such situations, for many clients, the safe choice is often a local firm that has performed well for other nearby school districts on similar assignments. That said, a new firm led by a principal who has worked successfully for the school district in question or other nearby districts while employed by another firm might still have a chance. To be successful, however, the new firm has to be prepared to deal with the conservative nature of committee decisions. Most committees vote for the "safe" choice, and a new firm, understandably, is often not regarded as such because its capabilities are untested and its name is unknown. Therefore, it is common for new firms to associate with an established firm to overcome this problem and begin to establish its reputation.

For an interior designer seeking to do a medium-size office renovation, the issues may be different. In many cases, the broker, the owner's rep, or an in-house real estate professional may be the decision maker. Because these decision makers may feel that any experienced interior designer can do the project, the decision may hinge on personal chemistry or a past working relationship that convinces this decision maker that the designer will make him or her look good to the ultimate users of the space.

For a mechanical engineer seeking to be involved in school projects, the decision maker may be the

architect for the school, who will need to be confident that the engineer:

- Will be responsive, will meet the schedule, and will correct any problem as soon as it arises
- Will be easy to work with
- Understands the building type
- Will be able to accommodate the architect's contractual and fee arrangement with the owner

The point of these examples is to illustrate that, initially, to be selected as the design professional on a given project hinges on your making the decision makers believe that you and your firm are the most likely to satisfy their needs and assuage their major concerns. Research of a market or specific client can clarify what these concerns are likely to be, thus giving the professional seeking to serve that market a significant advantage.

Insider Information

A second key issue is to identify those who know about a project before the selection of design professionals begins. In most cases, a number of people know about a potential project—sometimes many months or even years before the client begins selecting a design professional.

For some building types, anyone involved in defining the need and scope of a project (the board or senior management, planning consultants, feasibility consultants, etc.) are the first to know. On other projects, "those in the know" might include anyone involved in finding the space or site for a project (real estate brokers, site selection consultants, local public officials, etc.). On still other projects, family and/or friends of the potential client might have foreknowledge of the project.

Finding out who has advance knowledge of a project can help to guide a design professional early in the process. For example, firms interested in designing lab facilities cultivate relationships with lab planners, as well as with the staff of research organizations. Firms interested in working on corporate interiors projects cultivate relationships with real estate brokers, owners' representatives, and the facilities staff of major corporations. The point is, for every project type, there is a network of contacts that can provide early intelligence.

Client Selection Process

The third topic to research and understand is the selection process. Though there are no standard selection procedures, for most building types, there are typical steps to take and typical hurdles to cross in the selection process. After you have been through 20 or 30 interviews, you will have taken most of the typical steps and heard most of the standard questions. Therefore, it is helpful to gain experience in interviews while working for others and before your own firm's survival depends upon your skill in this process. However, even if the process is not familiar to you, much of it can be learned from other design professionals who have been through it.

In its basic outline, most selections go through the following steps, either formally or informally:

1. The potential client decides that it needs assistance.
2. The client asks others for help in generating a list of firms to consider.
3. The client contacts the firms and asks them if they are interested and, if so, requests material detailing their capabilities and experience.

4. Based on the information received, the client draws up a short list of firms to interview.
5. The client interviews and requests written fee proposals.
6. The client checks references and/or visits select projects completed by the firms under consideration.
7. The client selects a firm.

Of course, there are variations on these steps. Public agencies, large institutions and corporations, and clients using professional advisers may formalize the process, whereas an individual homeowner or a developer used to making his or her own choices may handle these steps very informally.

References Clients Use

As can be seen from the description of the selection process, there are at least two ways in which third parties can be very influential: helping assemble the list of firms to be considered, and providing references. As will be discussed again later in this chapter, these third-party endorsements are often more important than the interview or proposal. Therefore, knowing whom potential clients might ask for referrals (e.g., real estate brokers for houses or office interiors, lab consultants for research facilities, school superintendents for schools, etc.) can help define for you who you want to know, like, and respect you.

Identifying Trends

It is, of course, easier to win projects when there is more work in a given area than the local competition can handle. For that reason, some architects and interior designers even move their practices to follow a trend—for example, to growing resort areas

like Jackson Hole. In most markets, it's not necessary to take such a drastic step; instead, become adept at spotting trends that could generate a need for projects in the future (e.g., new medical technology that hospitals will need to implement; new educational initiatives such as mandatory early childhood programs, which will require expansion of schools; or new concerns about meeting sustainable design requirements). Many firms owe their success to their ability to spot trends and to position themselves to respond to emerging needs.

Recognizing the Good Clients

Of course there are clients who respect their design professionals, are fun to work with, pay their bills, and help the designers get future work. Unfortunately, there are also many who are abusive, litigious, and unlikely to pay what they owe. A common mistake on the part of new firms (and many experienced firms as well) is to ignore the warning signs of the latter type. Usually, a little research, such as calling other design professionals or people familiar with the community, can give an indication of what a client is like and whether working for them is likely to be a positive or negative experience.

Prevailing Fee Levels

Conversations with other design professionals and others can also help new firms define the current fee levels they can and should charge for various project types. There is a "going rate" for most projects, and most clients take the fee proposal into consideration during the selection process.

Tapping Complementary Firms

Other complementary (noncompetitive) disciplines and firms that serve the same market you are targeting can be valuable sources of leads, advice on fees, background on clients, information on trends, proposal partners, as well as offer other important assistance.

Typical Market Analysis and Plan for a New Firm

Market: *Private Residence.* Forty-five custom homes were built in the county last year, and local realtors believe this number will increase this year and next. Most of these homes were built by five construction firms, and the land was purchased through four different realtors. The prevailing fees appear to fall in the 10 to 15 percent range, depending on the project size and complexity.

Lead Sources: Realtors and builders are the major source of leads.

Competition: About half of clients come with their own architects; but, reportedly, because they are new to the area, the other half ask for advice. At this time, two architectural firms are viewed as offering little in the way of either design or service, and two others are generally respected but very busy. Most people believe there is room for another strong design firm that offers quality design and good service.

Strengths and Weaknesses: We have designed three houses for family and friends and have strong references from these and several other jobs. Our main weakness is that we are unknown to the key referral sources.

Plan: Over the next six months, we must meet all of the realtors and builders and present our credentials. We have to get at least one of our first houses featured in a local or regional publication or write one or more articles on home design advice for the local newspaper. We also need to become involved in community activities supported by the real estate industry.

Goals: *Year One:* One new house and two major house additions, with architectural fees totaling at least $175,000. *Year Two:* Five new houses with architectural fees totaling $400,000.

Identifying Competitors and Competitive Position

The second part of the marketing plan is to understand the competition. You need to answer these questions:

- How have our competitors become successful?
- How are they viewed by our potential clients?
- What are their strengths and what are their weaknesses?

Then you need to analyze your own position in the same way. Even a new firm has strengths as well as weaknesses. The strengths may include clients, friends, or family members willing to help introduce you to potential clients; strong experience in a particular building type or geographic area; the time to work more exclusively for a new client; and the willingness to offer a more competitive fee or more service for the same fee.

Writing Targeted Market Plans

With this analysis complete, it is a worthwhile exercise to write out a plan for each target group of clients. This plan should summarize what you know:

- Market and primary client targets
- Sources of leads
- Your competitive strengths and weaknesses
- One- and five-year plans
- One- and five-year goals

In addition, even in the first year of a firm's existence, it is important to begin creating the support materials that can be important to both marketing and sales. These materials may include:

- Brochure
- Website

- Reprints of material published on the firm or its principals
- Graphic, technical, and photographic records of projects

We'll discuss each of these promotional materials in turn.

Brochures

Obviously, your first brochure will be short of completed buildings. (A reviewer of our first brochure commented, "What a good model shop you have.") To address this shortcoming, *if appropriate and acceptable*, you can use projects completed for a previous employer. A word of caution here: Be sure to credit your former employer and to be accurate about your role and responsibilities. Typical wording in such a case might be, for example, "Project architect while a senior associate at Able & Baker Architects." Failure to properly credit your former employer can lead to negative publicity, claims for unethical conduct, and even legal action. That is not the right foot to start from.

In general, brochures should be designed for maximum flexibility, so that you can update or customize them as required. Most firms develop their brochure materials using a desktop publishing program or some other computer-based system. This allows you to continually update the brochure and adapt it to respond to each client's specific issues.

Typical sections you'll want to include in your brochure are:

- Description of the firm and its basic approach or philosophy (Remember you're writing for clients, not other architects, so use client-appropriate language.)

- Description of the firm's services
- Resume(s) for key personnel
- Client listing
- Project sheets with good graphics and descriptive materials for each of the firm's projects
- Reprints of articles, lists of awards, and other supplemental materials

Website

An ever-increasing number of potential clients, potential employees, and others use the Web as an initial screening tool in their selection process, so launching a website has become increasingly important for design firms. In fact, in the future, websites may replace traditional brochures. A new firm's site does not have to be elaborate, as long as it's well presented. To determine what to include on yours, look at how other smaller firms have set up their sites.

Article Reprints and Other Materials

Like awards, appearing in print gives third-party credibility. It is important to look for opportunities to get your firm's name or the names of its principals in print, whether in articles you or other team members write or those written about your work. Such exposure not only helps build your reputation, but reprints or copies of the articles can remain useful for a long time as marketing tools.

If you have something interesting to say or something good to show, you'll find it is not that difficult to get published. Though fewer design magazines exist today, there are hundreds of other magazines, newspapers, and other venues that need interesting content. Publications read by potential clients are

particularly useful, but publication in the design press is also important since design professionals often sit on building committees or advise on who should be considered. Always remember that publications are in the business of selling newspapers and magazines, and most are constantly searching for interesting sources to help them increase readership. We both wrote articles, book chapters, and other material early in our careers, and doing so helped establish our professional reputations and credibility. And once you have been published, it becomes easier to be published again in the future.

Project Records

For many reasons, it is important to be meticulous about creating project files, and one of the most important is that they become resources for future marketing materials. And keep in mind that most firms trying to establish their design reputations supplement basic material created for each project with extra drawings, professional-quality photographs, and other content.

Building an Image

From the beginning, all marketing is part of building an image that complements and supports the type of firm you want to have. (This issue is discussed further in Chapter 9.) The quality of your work and service is, of course, the core of your firm's image, but it can be significantly enhanced by your marketing program, community activities, personal conduct, and many other factors. Building and protecting a strong, positive reputation can be critical to success because, often, "image is substance."

Generating Leads

Once you have the framework of your plan outlined, it's time to focus on generating leads. Most new firms think that this task will be more difficult than it is. In practice, you'll find that identifying potential clients and specific projects is one of the easier steps in your marketing and sales program.

There are three typical sources of leads for a new or small firm:

- Research
- Networking
- Proactive lead generation

Research can be as basic as reading local newspapers; obtaining lists of school superintendents, directors of facilities for local hospitals and corporations, and other clients with frequent need for design services; and identifying individuals who are likely to have advance knowledge of projects .

Identifying individuals who may know of projects in advance is one part of building and maintaining a network of contacts, sources of information, and people who will even help seek out leads for a young firm. For most successful firms, the network begins with school friends and family and is then aggressively expanded by active participation in community activities. In Brad's case, for example, one of the most productive sources of contacts came as the result of his coaching soccer for his three daughters. Over the last 15 years, each of his co-coaches identified a major project for his firm and referred them to still others.

Table 2.1 lists typical project types along with potential sources of advance knowledge and/or influence.

One of Brad's favorite pieces of advice came from his father. He said: "Everything leads somewhere." If you actively build and maintain a network of contacts, as it grows and mature, leads will appear from surprising sources. For example, in one recession year, Brad's firm interviewed three potential employees who later referred work to them. Though not in a position to offer them jobs at the time, the firm tried to help connect them with other potential employers. All three went to work for clients and

Table 2.1
Architectural Projects and Sources of Information

Market	Project Type	Those with Advance Knowledge	Those with Influence
Housing	Single-family Houses	Past clients Homebuilders Real estate brokers	Past clients Homebuilders Real estate brokers
Education	Public Elementary/ Secondary Schools	School administration School board Local newspaper Educational planners	Other school district leaders Influential members of the community Noncompeting architects
Health Care	Hospital Clinics and Specialized Facilities	Hospital boards and administrators Medical staff Health facility planners	Administrators and board members of other health care facilities
Interior Design	Office Interiors	Corporate management Corporate facility staff Moving consultants Furniture dealers Owners' representatives Interior construction companies	Other clients in the same industry Brokers Owners' representatives

later recommended the firm for projects, which were subsequently won.

But indirect methods will only go so far. Successful firms also take proactive lead-generation steps. No one likes making "cold calls," but often there are people in your network who will make introductions that lead to "warmed-up" calls. Some firms have even hired retired former clients to introduce them to their friends and colleagues (e.g., retired school superintendents and former nursing home administrators). In other cases, firm principals have simply asked friends to introduce them to a potential client over lunch.

Thus, by combining research, networking, and proactive efforts, you will be able to generate more than enough leads to keep a new firm busy with the next steps in the marketing and sales program, lead qualification and courting, and RFPs, RFQs, and responses.

Lead Qualification and Courting

Most firms find that they must generate a large number of leads to get one assignment. The traditional rule of thumb is that 10 to 12 "qualified" leads generate 3 to 4 interviews and 1 new job.

Any lead generation effort will identify those prospects that are worth pursuing and those that are not. Thus, it is important to try to evaluate, or "qualify," leads before spending time and energy following up. The qualification process, which may be as simple as a phone call to the client or a conversation with someone who knows them, should answer the following, and similar, screening questions:

Marketing Process or "Funnel"

Market research: Determine that a market exists; find out where the work is.

List-building: Compile names and addresses of potential prospects.

Lead-finding: Contact people to find actual prospects.

Courting: Maintain contact with prospective clients and continue to express interest.

Strategy research: Interview prospective clients to determine needs, preferences, project details, selection criteria and methods, and competition.

Strategy decisions: Determine whether to pursue a lead, as well as the specific selling message(s) and tactics for getting the job.

Proposals and paperwork: Make formal written presentations of the firm's credentials.

Interviews: Make formal personal presentations of the firm's key people and approach.

Closing: Convince the prospective client to choose you; sign the contract.

Debriefing: Find out why the successful firm won the job, even if you are the successful firm.

- Is the project "real"?
- Is the selection process open or has it already been narrowed to a short list?
- Do the skills and experience required match yours?

The leads that remain after the qualification process should be the ones worth pursuing (sometimes referred to as "courting"). This effort, if successful, will turn a lead into a request for a proposal or presentation.

Often it takes personal contact to get a client to agree to include your firm on the list for consideration. In one case, Brad's firm avoided being eliminated from the interview short list when the client's key decision maker met him and realized Brad was his daughter's soccer coach. Again, it is very impor-

tant to find a way to make personal contact and create a personal relationship with the client before the formal selection process begins.

RFPs, RFQs, and the Responses

The formal steps in the selection process often begin with a verbal or written *request for qualifications* (RFQ) or a *request for proposal* (RFP).

- The RFQ is typically used when a client wants to screen potential firms based on their capabilities and experience. Often an RFQ precedes an interview or an RFP.
- The RFP is used when the client wants to know—in addition to the firm's experience and capabilities—how the firm plans to approach the project, on what schedule, and for what compensation.

The most important questions you want answers to when responding to an RFQ include:

- Who else is getting the RFQ and how do they compare to you?
- What capabilities and areas of experience are likely to be of greatest interest to the client?
- Who is the client likely to ask for references?
- If there is a gap in your qualifications, is there a way to fill it?

The last question raises the question of *teaming*. One of the most common ways for a young firm to respond effectively to an RFQ or RFP is to join with another firm with greater and/or complementary experience and capabilities. Even established firms are often willing to team with a younger firm if it has developed a lead and received an RFQ or RFP that the more established firm missed.

It's Who You Know

When Brad's father's firm was brand new in the late 1930s, they heard that a leading suburban school system near Chicago was planning to build a new, state-of-the-art elementary school. Brad's father called on the superintendent, a friend of his father, to ask to be considered. The superintendent was polite, but said the project needed a team with more experience (Brad's father's team consisted of three men in their thirties).

Brad's father refused to give up and asked the superintendent if they might be considered if they had a senior advisor. The superintendent replied, "Such as?" Thinking on his feet and mentally reviewing a list of his father's friends, he said, "Eliel Saarinen." This naturally impressed the superintendent, who responded, "If you can get Eliel Saarinen, we will consider you." Brad's father immediately drove to Cranbrook, asked Saarinen to act as their advisor, and with Saarinen's (and Saarinen's son Eero's) acceptance, secured the commission. The school—Crow Island in Winnetka—became the foundation for Perkins & Will's national practice in educational facility design.

Your response to an RFQ or RFP should, of course, be structured to directly answer all questions asked, as well as to address the issues you believe are the central concerns of the client. "Boilerplate" responses that are not tailored to these issues are not usually successful.

You should also be sensitive to the fact that most clients will not take the time to read every word of an RFQ or RFP, therefore your responses include graphics, repetition of salient points, and other techniques to guarantee that your firm's important strengths are impossible to miss. The cover letter, for example, is one place where it is appropriate to reiterate the major points of your response.

The logical sequence of a response is also important. While many clients dictate how they want you to respond, a typical proposal—and the underlying

logic of the sequence of proposal sections—has many common elements. The sidebar titled "Typical Proposal Format" lists these elements, and each is discussed in turn below.

To reiterate, the *cover letter* should be more than a transmittal; it should reinforce the key points of the proposal.

The *cover* should be graphically attractive and illustrate something about your interest in the project, even if it is merely a picture of the client's site.

The *table of contents* should make it easy for the reader to find the responses to the RFP questions. This can be reinforced by a clear introduction and executive summary of the proposal's key points.

The *proposal* itself often begins with a statement describing the design issues to be resolved. This is an important section because it speaks directly to the client's concerns and sets up the reasoning for the proposed approach, team, and schedule.

The *approach* should be more than a listing of the phases and tasks. It should include elements that reflect how you plan to deal with the unique challenges of the project. Include such topics as: special techniques to create an efficient program, cost management tools that will keep the project on budget, quality-control procedures to minimize change orders, communications techniques to keep the client informed and involved, a sustainable design focus to address a client's environmental goals, and so on.

The approach section is usually followed by a *description of the key personnel* who will make up the design team, followed by an explanation of the role each member of the core project team will play, and their resumes. This section may also include state-

Typical Proposal Format

1. Cover letter
2. Attractive cover
3. Table of contents
4. Introduction and executive summary
5. Understanding of the issues
6. Proposed approach
7. Proposed design team:
   - ➤ Component firms
   - ➤ Key personnel, organization of the project team, and each person's role
   - ➤ Resumes
8. Proposed schedule
9. Proposed compensation
10. Relevant experience
11. References
12. Appendices of other relevant material

ments about the availability and commitment of the key personnel. In all proposals, the proposing firm should be able to offer a great deal of capacity and the willingness to commit the best-qualified personnel to the project at hand. Being able to commit principals to a project may be more credible from, and thus, an advantage for, a smaller firm.

A page outlining the proposed *compensation* typically follows these sections. Many clients expect a definitive fee estimate even when the scope, schedule, and many other areas are as yet undefined. In these cases, try to point out the issues that need further definition and then propose tying the fee estimate to some assumptions (such as an immediate start date, few meetings during the public approval process, an early construction start, etc.) that are likely to change. It's also a good idea to list consultant fees separately so that a high number on one consultant line does not make the entire proposal noncompetitive. (Chapter 4 has more on setting fees.)

The final sections contain the material that *demonstrates your qualifications*: past experience that is relevant, strong references (from whom you have secured permission to use their names and who are reliable), and other supplemental materials (article reprints, reference letters, lists of awards, etc.) that support the argument that you are the best-qualified team for the job.

Presentations

Typically, the next phase is an interview. Though there are many things to learn about presentations, 10 of the most important lessons are summarized here for the purposes of this discussion:

1. Though most jobs are won before the presentation, in some cases the presentation will be the deciding factor.
2. The best presentations are usually those that engage the client in an interesting discussion of the project at hand.
3. Memorable props help draw the client into the discussion. These may include: site models with multiple inserts, site analyses, lists of key issues to be resolved, and so on.
4. In a standard 30-minute formal presentation, its best to limit the content to express only five or six clear messages.
5. Committees have a hard time making a selection and usually begin by eliminating firms with an apparent weakness.
6. Selection committees typically aren't "warmed up" for the first interview, have trouble remembering or distinguishing the middle ones, and are often impatient with the last, so most firms prefer to be one of the later—but not last—interviews.
7. Presentations are theater, meaning that rehearsal always improves your performance.
8. Slide shows can be deadly unless they are concise, directly relevant, attractive, and interesting.
9. Keep the typical introductory, formal part of a presentation to less than 30 minutes, and finish with a lively, "first-act closer."
10. The question-and-answer period is often the most important part of a presentation. A lively, intelligent, and friendly Q&A period can end a presentation on the right note.

It is unfortunate how much weight clients give to a presentation when you consider that most presentations are limited to one hour or less, with half devoted to the formal presentation by the firm and

the remainder allocated to questions and answers. And because the principals of most new firms do not have the experience to make a compelling case for their firm in such a short time frame, they are at a disadvantage, especially if they are up against more established and experienced firms.

The new firms that succeed in surmounting the disadvantages of youth, inexperience, size, and/or a less established image usually do so by expending greater effort, by preparing carefully, and, simply, by being charming. For example, in the early years at Brad's firm, they went out of their way to meet the client *before* the interview. Not only did this give them insights as to how best develop their presentation, it also allowed them to create a personal connection with one or more of the interview committee members. We've said it before, but it bears repeating: In most cases, relationships trump experience in a client's mind.

In preparing for a presentation, several points are particularly relevant to keep in mind:

- *Clients are more interested in their project than in your firm*. Therefore, build most presentations to demonstrate your understanding of the client's issues and how you and your capabilities and experience can help them successfully address each of those issues.
- *Never underestimate chemistry*. Most people prefer to hire someone they like, trust, and can envision spending time with over the life of the project. Thus, it is important to be (or at least appear to be) at ease, friendly, and engaging.
- *Do not assume that a client will absorb every message you intend to deliver*. As noted previously, pick out the five or six you think will be most

important—for example, your ideas for their project, your analysis of the site, your approach to cost control, your sustainable design concepts, and so on. If you try to cram too much information into a brief presentation, the client may miss the relevant parts.

- *Many selections are made by a committee, which tend to make conservative and "safe" choices*. After each firm interview, many committees look for weaknesses to shorten the list. Thus, it is not uncommon for a committee to start by eliminating firms with a perceived weakness (even if they gave—on balance—a strong presentation.) Therefore, to survive the first cut, you must give the committee positive reasons to choose you. This is where working harder than the competition can make the difference. For a new firm, it is important to convey that you will work hard and bring more creativity to the project than the competition. Thus, it important to have done enough project analysis to be able to talk intelligently about the project.
- *It is important to finish the formal presentation on a high note*. Concluding by describing how you will manage the project, for example, is usually a downer. A better choice is to use a model, a site analysis, or some other prop as the aforementioned "first-act closer."
- *The question-and-answer period that follows the formal presentation is often as important as the presentation*. As with the actual presentation, some rehearsal can be helpful, especially for the questions that are predictable, such as, "Why should we consider a new firm?" Having a ready answer can be convincing; fumbling an answer can be fatal.

Closing

At the presentation—or in a subsequent meeting—there comes a time where the client must be encouraged to make a commitment. This often requires experience in identifying the issues (fee, commitment of principal's time, etc.) that will convince the client to take this critical step. Being a good listener is part of the process. The box below, "Selling and Closing," illustrates this crucial step.

Selling and Closing

This example of interactive selling and closing actually occurred.

A "supersalesman" was booked as a guest on a late-night talk show. The host had not met the guest before he was introduced by the announcer as the person who had just won a salesman-of-the-year award. For some reason, the host was suspicious and aggressive. He began the interview on a hostile note:

"Oh, yeah," he said. "Try to sell me something."

The salesman responded quietly, "What would you like me to sell you?"

Pointing to the top of his desk, the host said, "That ashtray. Try to sell me that ashtray."

"Why would you want an ashtray like that?" the salesman asked.

The host responded, "I'm a pipe smoker and it would help me keep things in order and keep the ashes off my papers."

The salesman said, "Those are good reasons to have an ashtray like that. It will certainly help you keep your desk clean and orderly." He went on, "What about that ashtray interests you?"

The host said, "It's crystal, and has a nice shape, and is heavy, and will hold down my papers, and refracts the light in an interesting way."

The salesman reflected back, "Yes, this ashtray is really attractive and weighty and will refract the light colorfully. How much would you pay for an ashtray like that?"

The host responded, "Oh, $15 or $20."

The salesman said, "I can let you have it for $15."

Case closed.

Debriefing

No matter how this long process turns out (that is, whether you win or lose the project), it is important to request a debriefing from the client. Most are willing to give an insight as to how their choice was made. In our experience, there are almost always surprises, and it can be very helpful to see how you and your presentation were perceived.

In the first year of practice, Brad's firm won an invited competition for a mixed-use project. They naively assumed that they were chosen for the superiority of the design solution. The client said the design solution was important, but what convinced him was the fact that it was a young firm, and he believed he would be its most important client. He also liked the no-frills, low-overhead office, which indicated to him that he would get more effort for the same fee. At the time, this deflated the firm's egos, but later they realized that he had given them important advice on what—as a young firm—they could emphasize in their next presentations.

Conclusion

Young firms tend to focus on marketing and sales only when business is slow, so the first point we want to reiterate here is that your marketing and sales efforts must be continuous, focused, and broadly based. To engage in these efforts only on a sporadic basis while you already have work is a sure way to impair the financial health of a young firm (the subject of the next chapter).

The second point we want to stress is that an essential aspect of a continuous marketing program is staying in touch with former clients. Not only

might they have, or know of, other projects, they can also serve as your best sales staff, because a strong reference or a friendly introduction from a satisfied former client can often turn a lead into a project.

Third, marketing and sales require an investment. New firms often have to spend 3 to 6 percent of their net fee revenues on preparing proposals, presentations, and brochures; on photography, entertainment, travel, and other related costs; and an equal amount of their billable time. As a firm becomes established, a range of 5 to 10 percent of gross revenues is more normal. (Chapter 3 defines these finance-related terms.)

Finally, a young firm should regard every potential project as part of the foundation for the firm's long-term practice. Some unglamorous initial assignments—such as a small study or a minor renovation—might help to build a client list, lead to an introduction to an important client for future work, or establish a solid reference. For example, Brad's firm's growing school practice began with a series of two room additions, renovations for a local synagogue and a church, as well as a pro bono project for a school for emotionally disturbed children. The foundation for two other practice areas were small feasibility studies. The point is, assess all opportunities strategically, and remember: "Everything leads somewhere."

Financial Management

3

It is a myth that one cannot make a reasonable living as a design professional. Though few of us get rich, and even fewer have achieved the "instant riches" possible in other fields, making a reasonable income is definitely possible. Many of us have been able to earn enough to buy a home, travel, educate our children, and save enough for a comfortable retirement. And having your own firm is one of the best ways to achieve this goal.

Although financial gain may not be the primary reason for a design professional to start a new firm, there is no escaping the fact that sustaining the firm will depend to a very great degree upon effective management of the firm's finances—with all its ramifications. This chapter describes the basics of financial management necessary to build and guide the financial health of a new firm: the principles, tools, and techniques that founders have to understand to manage their firms successfully.

Basic Concepts

The practice of architecture and other design professions is necessarily a business as well as an artistic pursuit, meaning that the fundamentals of finance apply to those practices regardless of size. Although the level of detail will vary with the volume of business, the number of staff, the size and complexity of projects, and other factors, maintaining a financially healthy firm is a prevalent concern for any business enterprise.

The objective of a firm's general management will be to ensure that the firm's efforts are integrated, balanced, and directed toward achieving goals. Marketing, project services, and general business cannot operate independently. Financial management is the core of business management and can be viewed as the integration of several components:

- *Funding:* Sources and applications of money.
- *General accounting:* Record of monetary transactions.
- *Project cost accounting*: Record-keeping of revenues, reimbursable expenses, direct expenses, and direct personnel time.
- *Profit planning:* Goals for profit and uses of capital and operating budgets.
- *Cash flow*: Change in the firm's cash position during a given period. Positive cash flow (more cash received than disbursed) increases the cash account; negative cash flow decreases the cash account.
- *Cash management:* Billing, collecting, and disbursing cash.
- *Remuneration*: Salaries and benefits.

- *Firm valuation*: Pricing for ownership transition.

Good management practice involves *understanding* what has to be managed, *planning* (establishing appropriate, realistic, and achievable goals), and *controlling* (achieving those goals through the effective employment of resources: people, time, money, facilities, and technology.

Essential Vocabulary

One of the most important of the basic financial concepts to master is the vocabulary. The world of financial management has its own language, and although much of it can be understood from context, we list here a few words and phrases that either have special meaning or whose particular understanding is essential to this chapter.

Accounts payable: Current liabilities in accrual accounting, representing the amount owed by the firm to vendors, consultants, or others for merchandise or services that have been provided to the firm.

Accounts receivable: Money owed by clients to the firm for services rendered or for reimbursement of expenses.

Accrual accounting: Accounting method that recognizes revenues as having been earned when services are performed, and that recognizes expenses when they are incurred, without regard to when cash is received or disbursed.

Asset: Resource owned by the firm on which a monetary value can be placed.

Backlog: Value of services contracted for but not yet earned.

Balance sheet: Statement of the firm's financial condition as of a specific date. It is a statement of the

balance between the asset accounts (cash, accounts receivable, equipment, etc.) and the liability (consultants payable, loans payable, etc.) and owners' equity accounts.

Book value: The owners' equity accounts representing the net worth of the firm; the firm's assets less its liabilities.

Cash accounting: Accounting method that recognizes revenue when payment is received in cash, and that recognizes expense when cash is disbursed.

Cash flow: The change in the firm's cash account during a given period. *Positive cash flow* (more cash received than disbursed) results in an increase in the cash account. *Negative cash flow* decreases the cash account.

Direct expenses: Costs that can be charged to specific projects. Included are the costs of staff working on the project, outside consultants, and other costs associated with the project such as printing, travel, and long-distance communication.

Equity: Value of the firm's assets in excess of its liabilities; the total claims the owners would have to the value of the business if all assets were liquidated and all liabilities paid, as reflected on the firm's balance sheet.

Expenses: In cash accounting, actual cash disbursements made for goods or services (which do not result in acquisition of an asset, distribution of profit, or reduction of a liability). In accrual accounting, expenses are recognized when they are incurred without regard to when payment is received.

Founder: The person or persons initiating the firm.

Gross revenues: Total value earned by the firm as a result of providing services or from aspects of the business not central to the primary purpose, such

as rents or royalties, including value provided by the firm's consultants and owed to them.

Income: Profits remaining after expenses have been subtracted from revenues.

Income statement: The basic operating financial statement showing the activity of the firm for the accounting period specified; synonymous with *profit and loss statement*.

Indirect expenses: Expense items paid in operating the business that are not chargeable to specific projects; collectively often called *overhead*.

Liabilities: Debts or obligations of the firm owed to others.

Loss: Expenses exceeding revenue in an accounting period.

Net income: Profit after corporate income taxes.

Net revenues: Value generated by the firm's employees, excluding value attributable to consultants or to nonlabor project expenses for reproductions, travel, and so on.

Net worth: The value of the owners' equity in the firm; basically, assets less liabilities: in a proprietorship, the proprietor's capital account; in a partnership, the total of the partners' capital accounts; in a corporation, the total of capital stock, plus paid-in capital, plus retained earnings.

Operating costs: The cost to operate the firm, including salaries, rent, supplies, and so on, usually expressed as a monthly total.

Operating income (or operating profit): Revenue remaining after direct and indirect expenses.

Owner: Anyone with a financial interest in a firm, whether as a sole proprietor, partner, or corporate shareholder.

Owners' equity: See Equity.

Partnership: Form of organization in which two or more persons share in the ownership, risks, and rewards of the business.

Principal: In this book, any individual with an equity position in a firm; sometimes expanded elsewhere to include anyone with a significant leadership role.

Profit: Excess of revenue over expenses.

Proprietorship: Form of business organization owned entirely by one person.

Reimbursable expenses: Project-related expenses that, by agreement with the client, are to be directly reimbursed.

Revenue: Primarily, value received from clients as a result of the firm providing services.

Shareholders' equity: See Equity.

Basic Finance Principles

This book constantly emphasizes the need to plan. This is especially true for a new firm's finances. And there are 10 principles to keep in mind when formulating that plan:

1. It is possible to make a reasonable living in your own practice, but it cannot be done without careful financial arrangement.
2. The core of financial management is knowing your costs, knowing your revenues, and keeping both in the proper balance.
3. You live on the cash basis of accounting, but you can die by ignoring accrual; you must know and monitor both.
4. Profit margins are narrow and limited; it is easy to lose more in a month than you make in

six months. The easiest way to increase profit margins is to reduce overhead, and for new firms low overhead is a major competitive advantage.

5. Professional help is essential. This may include a bookkeeper, an attorney, and a tax adviser.
6. Design professionals and their limited profit margins are very vulnerable. Good contracts and careful negotiation are important to reducing this vulnerability.
7. Doing something for nothing usually reduces the likelihood of it happening. Some things, however, are worth doing, even at low rates, if they fill in a hole or help build toward a long-term goal.
8. Old accounts receivable are like dead fish. They do not improve with age. Firm, friendly pressure on collections is necessary with most clients.
9. Having adequate working capital is critical. Cash flow problems can become all-consuming.
10. Remember Pharaoh's dream: If you have seven fat years, save for the seven lean years. They will happen.

Fees Projection

This book constantly emphasizes the need to plan. This is especially true for a new firm's finances. One of the most important financial tools is a fee projection—that is, you project the fees you think you can earn each month. This gives you a clear view of your financial future. The goal is to earn each month more than you think it will cost you to cover your monthly expenses (advice we will repeat throughout

TIP

After the contract negotiation, the most effective thing you can do to enhance project success is to plan the project at project initiation.

this chapter), including fair compensation for your own time.

The Cash Flow Worksheet on page 56 begins with an earnings projection for seven months. Shown each month are the amounts expected to be billed at the end of each month.

The Cash Cycle

For a new firm, another important basic concept to understand immediately is *cash flow*. In the final analysis, and at virtually every step along the way, cash is required to operate any business. Goods and services, labor and materials, must be paid for with cash, sometimes at the very moment those goods and services are purchased, sometimes when the credit card or vendor's bill arrives, or soon thereafter. The process by which cash is produced can be understood as a never-ending cycle, as shown in Figure 3.1. This cycle is depicted as a circle whose arcs represent actions that generate assets, and the segment divisions the assets that are created. Since circles have no beginning and no end, imagine that the cycle begins with the action of providing services.

The professional provides services to a client or clients. The professional pays for his or her own labor and that of others as the firm grows. In addition to those labor expenses, the professional also incurs other expenses, both direct and indirect, in order to provide services. He or she may pay for travel, reproductions, postage, and other expenses in connection with executing the project. He or she will also pay for all those indirect, or overhead, items necessary to "keep the door open," including rent, utilities, insurance, taxes, and so on. The asset produced by performing services is called *work-in-process*.

The next action in the cycle is *billing*, or *invoicing*. The professional prepares an invoice requesting payment for the services provided—the fee—in whatever form he or she and his or her client have agreed. The asset produced by that action is called *accounts receivable* and represents the value of the services performed.

The next action is called *collecting*, and the asset produced is cash. Sometimes, collecting monies owed to the firm for services provided requires little or no specific action; simply sending the bill is enough. However, if payment is not made in a reasonable time, follow-up may become necessary to ensure that the payment will be forthcoming.

Once collected, cash is used to pay for obligations that have been incurred in the course of busi-

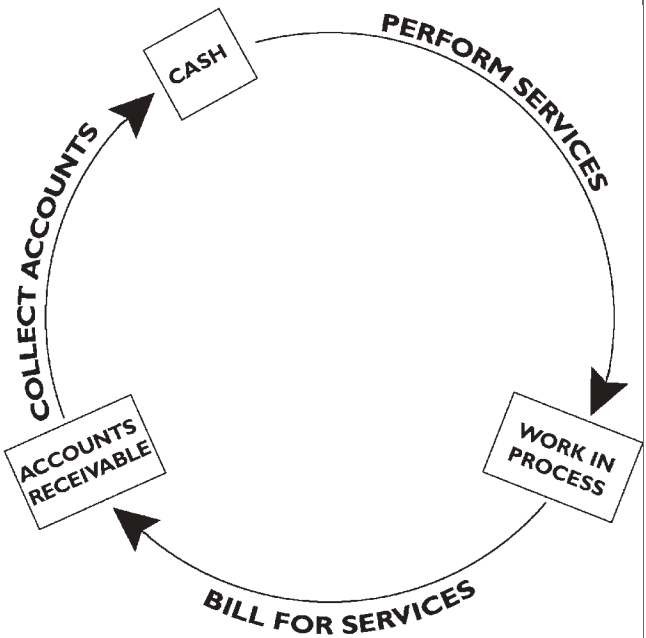

Figure 3.1 Cash Cycle.

	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7
Billings	$36,000	$34,000	$33,000	$38,000	$40,000	$35,000	$32,000
Collections							
First Month (25%)	9,000	8,500	8,250	9,500	10,000	9,000	8,000
Second Month (60%)		21,600	20,400	19,800	22,800	24,000	21,600
Third Month (15%)			5,400	5,100	4,950	1,425	6,000
Other (nonoperating) Receipts			1,000	1,000	1,000	1,000	1,000
Total Cash Receipts (Cash In)			**34,050**	**35,400**	**38,750**	**35,425**	**36,600**
Cash Disbursements							
Direct Expenses			14,900	15,500	17,000	15,940	16,000
Indirect Expenses			16,000	17,500	15,200	17,500	20,750
Other (nonoperating) Disbursements			200	0	600	0	0
Total Cash Disbursements (Cash Out)			**31,100**	**33,000**	**38,200**	**33,440**	**36,750**
Net Cash Gain (Loss) during month			2,950	2,400	550	1,985	(150)
Cash Balance at beginning of month			1,500	4,450	6,850	7,400	9,385
Cash Balance at end of month			4,450	6,850	7,400	9,385	9,235

Figure 3.2 Cash Flow Worksheet.
Adapted from *Financial Management for Architects* by Robert F. Mattox, The American Institute of Architects, 1980.

ness and that will be incurred in the immediate future as the firm continues to provide services—capital expenditures necessary to grow the firm, and operating expenses for salaries, consultants, other direct (project) expenses, and indirect (overhead) expenses. The cycle continues as long as the firm stays in business.

Cash Flow Projection

The projection of earned revenues described earlier can be combined with the concepts of the cash cycle to create a simple tool that allows you to project your cash position in the future (that is, determine whether you still have some or will run out). This tool is a *cash flow projection*.

You create this information by taking the *revenues* (fees earned) as the first step in the Cash Flow Worksheet, Figure 3.2, and estimating when they will actually be received. This will give you the total cash expected each month. Then you project when you will have to pay your expenses (rent, salaries, etc.). Eventually, you will have a good estimate of the total monthly cost to operate (and most of these costs must be paid monthly).

The only major expenses that can sometimes be deferred until you have received client payment are the consultant fees. If you have been paid or reimbursed for a consultant's fees, however, it is important to pay them. Many firms have gotten into serious trouble by treating consultants' fees as if the money were their own, rather than the consultant's money.

Cash and Accrual Accounting

The most basic financial management task is to ensure, on a regular basis (preferably, monthly), that the firm's revenues are consistently greater than the firm's expenses. We emphasize the need to do this every month because design professionals have narrow profit margins. It is easy—if workload declines sharply—to lose more in one month than can be earned as profit in three to six months. If a

TIP

You can make or lose more in the contract negotiation than in any aspect of project execution.

firm can accomplish this positive relationship between income and expense, it should be financially successful. So what are the tools you need to use to help you be successful?

If the firm recorded its finances the way many ordinary household finances are recorded—that is, on the cash basis, revenue would be recorded when it was received, and expenses would be recorded when they were disbursed. If positive, the difference between revenue and expense would indicate profit (or surplus); if negative, loss (or deficit).

Now imagine that a firm starts in business on January 1, and chooses to record its finances on the cash basis, as described. In January, then, the firm would pay its staff, rent, insurance, taxes, and other expenses, direct and indirect, that were due. By the end of January, it probably would not have invoiced for the services it provided that month, nor collected any money for those services. Using the cash basis of accounting the firm would record no revenue and all expense, and therefore would report a loss for the month's operations.

In February, the firm would likely prepare and send an invoice for the work it had done in January. It also would pay its staff, rent, insurance, taxes, and so on, but still might not have received payment for services that it performed in January and invoiced at the beginning of February. Again, on the cash basis of accounting, the firm would record all expenses and zero revenue, and report a loss for that month also.

In March, the firm would invoice for services performed in February. It would pay its incurred direct and indirect expenses for the month, and might have received payment for the services per-

formed in January. Now the firm would record the value of the revenue received in March for services performed in January, and would record the expenses paid in March. On the cash basis, the firm would record a profit if the revenue it received exceeded the expenses it disbursed that month, but would record a loss if expenses disbursed exceeded revenues received.

Clearly, this method of recording revenue and expense does not accurately or fairly describe what happened in the firm with respect to profit or loss. The firm may actually have practiced profitably in January and February, but since it did not receive the cash that would have represented the value the firm was entitled to for having performed the services, using cash basis accounting, it had no way to record that value. Conversely, in March, the firm may or may not have been profitable; there is simply no way to know by counting only cash received and disbursed.

Despite this anomaly, the importance of emphasizing cash at the beginning cannot be exaggerated. Cash will always be important, but particularly at the beginning of a firm's existence. Typically, the founders of the new enterprise will have invested their own money; in fact, they may have exhausted their personal resources. It will take cash receipts to keep the practice solvent, and sooner rather than later. Later, as the firm develops a body of work and the expectation (but never the certainty) of a consistent flow of new work, management on the accrual basis becomes more important as the only way to truly understand whether the firm and its projects are profitable. Counting the cash on hand is not, and never will be, an accurate way to do so.

Recognizing that cash accounting can be misleading (if not balanced by additional tools described in this chapter) it is, nevertheless, still a critical measure of a young firm's financial health. All young firms are cash-starved; and cash accounting will help guide a new firm to a healthy beginning.

Accrual Accounting

The *accrual* basis of accounting is a method established to reflect the true financial performance of a firm during a specific period of time by matching revenue earned with expenses incurred. In the accrual basis of accounting, revenue is recognized (recorded) when it is *earned,* and expenses are recognized (recorded) when they are *incurred*. Profit (or loss) again represents the difference between the two, regardless of whether cash has been received or disbursed. In an architecture or other similar design firm, the most important objective of accrual-basis accounting is to match revenue with expenses during the period in which the revenue was generated, to determine profitability on a current basis. Using accrual-basis accounting, the firm can accurately record whether it is making or losing money on both a project- and firmwide basis for any month and the year.

Though more accurate , accrual accounting is just one tool. You will almost certainly calculate and pay your taxes on a cash basis, and most new firms are so cash-poor that cash accounting is an extremely important short-term indication of financial health. In the long term, you may live on a cash basis, but your firm can die if you ignore accrual. The staff at the first firm Brad worked for as a consultant

thought they were doing fine because each month their cash receipts totaled more than their monthly expenses. What they failed to recognize was that the cash receipts were for work done earlier in the year. On a current basis, they were actually earning less than their expenses. This soon became a crisis.

It need not be said that to succeed, firms must remain both profitable and solvent. The firm's principal(s) should regularly monitor both the firm's cash position and its profitability. Failure to practice profitably over time will, in the short term, inhibit the firm's ability to provide appropriate rewards to the people who contribute to success. In the longer term, lack of profitability will cause the firm to deplete its cash and/or its access to cash, creating insolvency—the inability to pay debts when they become due—leading to bankruptcy.

TIP

Most firms calculate and pay taxes on a cash basis, so it is very important to have tax advice before year-end. Sometimes you may want to delay receipt of a client payment to beyond year-end, or prepay some expenses to minimize tax exposure.

Projecting Workload

As noted in Chapter 2, securing a steady flow of work is an essential step in building a successful firm. The next is to match a projection of the fees that will be earned against the expenses that will be incurred in providing the commissioned services.

Envision two partners, Able and Baker, who are setting out on their own after several years doing moonlight projects while working full-time in a larger firm. To start, they have four projects: three house additions from friends and family, plus a small office renovation that their former employer has given them.

The first step is to estimate the fees they will earn over the next 12 months from these four projects (the *contracted backlog*), as well as what additional work they might get as the year goes on. This projec-

Fictitious Firm

Throughout this book, we use a fictitious firm, Able & Baker Architects, to exemplify the concepts, principles, and procedures presented in this book. Able & Baker Architects is described in the case study on the next page.

CASE STUDY

Introducing Able & Baker Architects

John Able and Jean Baker, thirty-two and twenty-eight years old, respectively, decided to start a practice together. Though they attended different schools before their internship, they were both hired as staff architects in a 40-person firm owned by three architects, all more than 10 years older than they were. Although the three principals had acknowledged the gradual growth in Able's and Baker's professional capabilities by assigning them more complex and important project responsibilities, the two were not comfortable with the firm's overall direction, nor with what they thought would later be significant limitations on their future professional growth and compensation.

In spite of their different personalities, interests, and skills, Able and Baker had developed a comfortable and productive working relationship in the firm, so much so that they began doing small-scale "moonlight" projects together.

Baker's outgoing personality enabled her to connect easily with people and inspire their confidence. She became active in her community's civic organizations, and expanded her undergraduate interest in the arts to become involved in arts-related organizations, as well. In collaboration with Able, whose technical skills complemented her own design and people skills, the duo created a team capable of acquiring and executing small projects successfully while they were still employed. Determined to depart on good terms and not burn bridges, they planned to set up their own practice only after they had completed the large projects on which they were working. Ultimately, they left with the blessing of their employers, along with a referral and recommendation for a project that was too small for the larger firm to want to execute, plus two small projects of their own that were nearing completion, and another about to start.

tion is always an estimate, of course, but it serves to provide some key information. Figure 3.3 indicates the fee projection that Able & Baker prepared three months after they started their firm. The projection records the net fees (excluding consultants and other

Project	Gross Fee	Net fee	Net Fee Earned to date	Net Fee Remaining	Schedule
A	$ 20,000	$ 20,000	$ 20,000	$ 0	3 months
B	30,000	25,000	15,000	10,000	3 months
C	60,000	45,000	15,000	30,000	6 months
D	140,000	120,000	30,000	90,000	9 months
Proposals @ one-third of proposed fees	150,000	120,000	0	120,000	12 months
Total	$400,000	$330,000	$ 80,000	$250,000	

Figure 3.3 Able & Baker Fee Projection at Three Months.

nonsalary direct expenses) for projects for which they had secured contracts, the value of their services to date (again, excluding consultants), and the amount remaining—the backlog. Their projection also includes the amount they expect to receive from the prospective commissions on which they expressed interest and were asked for proposals. Since they know they will not likely get all of them, they projected the value at one-third. As they gain more experience and develop a track record, these projections will become more accurate.

Invoices and Accounts Receivable

We strongly recommend that firms bill for services monthly (or on an even shorter cycle if clients permit) and that they follow up if the invoice is not paid within 30 days. Many clients will hold up payment if they have questions. Some invoices do get lost (but not as many as some clients claim), and some clients pay only when asked. Friendly follow-up is essential. Remember that accounts receivable are like dead fish; they do not improve with age.

Expense Projection

At the same time that fee projections are being estimated for the first year, it is important to project the expenses that the firm expects to incur during the same period. These are typically divided into startup expenses (setting up the office, rent deposits, stationery printing, etc.) and ongoing operating expenses (e.g., rent, supplies, and the modest salaries the partners expect to be able to pay themselves, at least until they can assure themselves of profitable operations and adequate cash flow). (A checklist of startup expenses is shown in Chapter 11.)

By matching the timing of expenses and the likely timing of fee payments, it is possible to form a reasonably good picture of the capital needed to start the firm and keep it afloat during the first year. The document traditionally used to match receipts and disbursements is called a cash flow projection. Figure 3.4 details Able & Baker's cash flow projection for their first year in business together.

The Income Statement

The income statement, sometimes called *a profit/loss* or *income and expense statement* records the *operations* of the firm over a specific period of time, usually a month, quarter, or year. It categorizes and summarizes the operations of the firm into three major areas: *revenues*, *expenses*, and *profit* (or loss). We strongly recommend that all design firms divide, allocate, and record expenses into three subdivisions: reimbursable, direct, and indirect expenses. These categories of expenses are explained in the following subsections, and Figure 3.5 portrays the accrual-basis income statement of Able & Baker Architects at the end of its first year of practice.

Category Total	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	First Year
Billings	$50,000	$60,000	$80,000	$60,000	$250,000
Collections	40,000	40,000	60,000	60,000	200,000
Total Receipts	**40,000**	**40,000**	**60,000**	**60,000**	**200,000**
Disbursements					
Salaries	30,000	30,000	30,000	30,000	120,000
Consultants	5,000	5,000	10,000	10,000	30,000
Other Direct Expenses	2,000	2,000	2,000	2,000	8,000
Nonsalary Indirect Expenses	13,000	13,000	13,000	13,000	52,000
Total Disbursements	**50,000**	**50,000**	**55,000**	**55,000**	**210,000**
Net Gain/(Loss)	**(10,000)**	**(10,000)**	**5,000**	**5,000**	**(10,000)**
Beginning Balance	10,000 loan	0	(10,000)	(5,000)	10,000
Ending Balance	0	(10,000)	(5,000)	0	0

Figure 3.4 Able & Baker First-Year Cash Flow Projection.

Income Statement on December 31, 2002

Revenues		
Gross revenues	$250,000	
Reimbursable revenue: consultants	(40,000)	
Reimbursable revenue: reprographics, travel	(10,000)	
Net revenue: architectural fees	$200,000	100.0%
Direct and Reimbursable Expenses		
Direct salary expense	$ 72,000	36.0
Consultant's expense	40,000	20.0
Reprographics, travel, etc.	10,000	5.0
Total direct expenses	$122,000	61.0%
Indirect Expenses		
Indirect salary expense	$ 48,000	24.0
Payroll and benefits expenses	22,000	11.0
Occupancy expenses	10,000	5.0
General administrative expenses	20,000	10.0
Total indirect expense	$100,000	50.0%
Profit (Loss)	$ 28,000	14.0% of net revenues 11.2% of gross revenues

Figure 3.5 Able & Baker Architects Income Statement.

Self-Payment

The statement in Figure 3.5 indicates that for the 12 months ending December 31, 2002, Able & Baker Architects generated revenues (but not necessarily cash) of $250,000: $200,000 was generated by its own forces; $40,000 was generated by consultants, whose expenses were reimbursed; and $10,000 was generated as reimbursement of project expenses incurred in the interest of the project.

Direct expenses included direct salary expense of $72,000, representing the portion of the principals' salaries expended on projects (there being no other employees in the first year of practice). The $40,000 and $10,000, respectively, represent expenses for consultants and other nonsalary direct expenses, both reimbursed by the owner in this example.

Indirect expenses included indirect salary expense, representing the portion of the principals' and employees' salaries expended on overhead activities such as vacation, holiday, sick, and personal time; marketing, management, secretarial, and bookkeeping services. In addition, indirect expenses include all other expenses incurred to "keep the doors open" (payroll taxes and other mandatory and customary benefits, occupancy expenses, and general and administrative expenses).

Segregating direct and indirect expenses allows the principals to examine the firm's performance on projects, as well as their control of overhead. Also, when broken down in finer detail, these delineations can be used to develop a budget for future projects and for the next accounting period, generally one year.

NOTE

Regarding direct salary expense, note that even if a principal is a proprietor, or the principals are partners, for management purposes it is useful to treat their profit draws as if they were salaries. It is the only way to track the true cost of performing services (on the reasonable assumption that the principals work on projects), and it is the only way to compare the firm's performance against the norms established by all other firms.

NOTE

Although some firms prefer to allocate benefits to direct salaries and record the resulting direct personnel expense, the great majority record benefits as indirect expenses.

Balance Sheet

Unlike the *income statement*, which is a statement of operations that reports financial activities that

occurred over the span of time identified in the statement, the balance sheet is a report of *status*, or condition that indicates the firm's financial condition at a specific point in time—specifically, at the date of the report.

Balance sheets are divided into two sections of equal value (hence the balance):

- Assets
- Combination of liabilities and net worth

Assets can be understood as those tangible and intangible resources with monetary value owned by, or owed to, the firm. Liabilities are debts or obligations the firm owes to others; *net worth* is the value owned by, or owed to, the firm's owners. The sum of the assets minus the sum of the liabilities equals net worth. In theory, if the firm were able to collect or redeem all its assets, and pay all its liabilities, the owners would realize their net worth in the firm. Standard, double-entry bookkeeping procedures are designed to maintain this essential balance whenever a financial transaction is recorded.

Figure 3.6 shows the accrual-basis balance sheet of Able & Baker Architects that reveals the financial condition of the firm at the end of its first year of practice: December 31, 2002.

Current assets include all those expected to come due within one year. The firm's current assets on December 31, 2002, indicate that Able & Baker Architects owned $5,000 in cash and deposits, and was owed $45,000 by clients who had not yet paid their invoices for services rendered. Work-in-process records the value of services performed but not billed by the date of the report. Once billed, that amount, $10,000 will be added to accounts receivable and subtracted from work-in-process; because

Balance Sheet at December 31, 2002	
Assets	
Current Assets	
Cash	$ 5,000
Accounts Receivable	45,000
Work in Process	10,000
Deposits	2,000
Total Current Assets	$62,000
Long-Term Assets	
Furniture and Fixtures	$11,000
Computer Equipment	10,000
Less Depreciation and Amortization	(3,000)
Total Long-Term Assets	$18,000
Total Assets	$80,000
Liabilities	
Current Liabilities	
Credit Line Payable	$20,000
Note Payable: Equipment, Current Portion	2,000
Accounts Payable: Consultants	10,000
Accounts Payable: Trade	2,000
Other Accrued Expenses	3,000
Total Current Liabilities	$37,000
Note payable: Long-Term Portion	$ 8,000
Total Liabilities	$45,000
Net Worth	$35,000

Figure 3.6 Sample Balance Sheet for Able & Baker Architects.

the firm recorded the asset when it was earned, the conversion from work-in-process does not change the value of total assets, nor will it change the value of assets when the client pays the bill and Able & Baker Architects receives the cash. Once earned, the receipt of cash represents the exchange of one asset for another asset that was reported when the revenue was earned.

On December 31, the firm owned $21,000 worth of furniture, fixtures, and equipment, of which $3,000 had been depreciated or amortized by the end of one year. The firm owned no other assets.

The firm's liabilities included $20,000, which had been drawn down on a bank credit line that was arranged by the founders, and a $10,000 equipment loan, of which $2,000 was due within one year and $8,000 over the balance of the loan. Liabilities also included $10,000 payable to consultants (within the $45,000 accounts receivable), $2,000 in trade accounts payable (such as credit cards, reprographics, etc.), and $3,000 in miscellaneous accrued expenses (e.g., vacation, salaries).

In sum, then, as of December 31, 2002, the owners of Able & Baker Architects had a firm whose net worth, or *book value*, was $35,000. That means that if the owners chose to go out of business at the end of the accounting period, and they were able to realize (collect) cash for everything that they owned or were owed, and then used that cash to pay its debts to consultants, vendors, and the bank, they would have $35,000 (on which they would be taxed for any amount over the cash value of their initial investment).

Office Earnings Report

Although it is possible to produce any number of reports that will explain or clarify a particular financial transaction or condition, the Office Earnings Report, shown in Figure 3.7, best serves the design professional.

The Office Earnings Report displays critical financial information for each project in the firm, line by line. It indicates for each project, from its inception to date:

- The amount earned (again, regardless of how much was billed or collected)
- Of the amount earned, how much was billed
- The amount unbilled at the time of the report
- Of the amount billed, the amount received
- The amount unpaid and receivable
- The amount spent to earn the amount billed
- The profit (or loss) to the firm

This report also indicates how much was earned and spent and how much profit (or loss) was achieved in the year to date by each project.

The Office Earnings Report for Able & Baker Architects on December 31, 2002, the end of their first year of practice, indicates that the firm worked on four projects. On Project A, the firm expended $20,000 to earn $20,000, all of which was billed and received by the end of the year. On Project B, the firm expended $26,000 to earn $30,000, of which $30,000 was billed and received. On Project C, the firm expended $50,000 to earn $60,000 ($60,000 was billed

Office Earnings Report on December 31, 2002
(In thousands of dollars)

	Project to Date							Year to Date		
Project	Earned	Billed	Unbilled	Rec'd	A/R	Spent	Profit (Loss)	Earned	Spent	Profit (Loss)
A	$ 20	$ 20	$ 0	$ 20	$ 0	$ 20	$ 0	$ 20	$ 20	$ 0
B	30	30	0	30	0	26	4	30	26	4
C	60	60	0	45	15	50	10	60	50	10
D	140	130	10	100	30	126	14	140	126	14
Total	$250	$240	$10	$195	$45	$222	$28	$250	$222	$28

Figure 3.7 Sample Office Earnings Report for Able & Baker Architects.

and $45,000 was collected, leaving $15,000 in accounts receivable). On Project D, the firm expended $126,000 to earn $140,000, of which $130,000 had been billed and $100,000 had been collected, leaving $30,000 in accounts receivable and $10,000 remaining to be billed. In total, the firm earned $250,000, of which $240,000 was billed and $195,000 collected, leaving $10,000 remaining to be billed and ultimately collected, along with the $45,000 in accounts receivable. The overall profit for the firm in its first year was $28,000.

The year-to-date values for each project are identical to those for project-to-date because the firm started in business that year, hence no project went beyond one year. Since projects can start in one year and not be completed until the next, year-to-date values on projects will typically be less than those for project-to-date.

During the year, the firm incurred both direct (project-related) and indirect (overhead) expenses in the course of doing business. The direct expenses (direct salary expense, consultant fees, reproductions, travel, accommodations, etc.) incurred for specific projects were directly attributed and assigned to those projects for which they were incurred. Since indirect expenses are expended in the interest of the firm as a whole, not for a given project, they must be allocated in some way so that each project shares its portion of the total. Although there are several ways to allocate indirect expense (overhead) to projects, the most conventional is to allocate indirect expense to each project in proportion to that project's direct salary expense relative to total direct salary expense.

On Able & Baker Architects' Office Earnings Report, the "spent" amount for each project includes direct salary expense and consultant fees, plus other

direct expenses such as reproductions, travel, and so on; and that project's pro rata portion of the firm's total indirect expense in the period reported.

In addition to ensuring that each project bears its portion of the firm's overhead, the allocation of indirect expense to projects in this way makes it possible to integrate the management reports, so that the bottom line of the income statement—profit or loss—equals the profit (or loss) at the bottom of the Office Earnings Report.

Economic Structure

In the 1960s, the American Institute of Architects (AIA) commissioned the management consulting firm of Case & Company to study the economic structure of architectural practice (see Figure 3.8). Case found that for each $1.00 in salary expense that firms spent on a project, they incurred an additional dollar to cover that project's portion of the firm's overhead cost. Therefore, the breakeven for such operations was $2.00 ($1.00 + $1.00 = $2.00). Firms were accustomed to adding $.50 for profit, to create a billing multiple of 2.5 times direct salary (2.5 × $1.00 = $2.50). This provided a 25 percent markup on cost (.50 ÷ 2.00), and a 20 percent profit relative to revenue (.50 ÷ 2.50).

By the mid-1970s, the economic structure had changed. Whereas overhead relative to direct salary expense had been 1:1 in the two preceding decades, average overhead in established firms had risen disproportionately to other expenses to 1.5:1. That is, by the 1970s, most established firms were incurring overhead costs of $1.50 for each $1.00 of direct salary, creating a breakeven of $2.50, where it had been $2.00.

Firms that were accustomed to proposing and getting fees based on a multiple of 2.5 times direct salaries found that they were barely covering the cost (including overhead) of doing the work. Since overhead costs could not be cut, two options were possible: *increase the billing multiple* or *increase the billing base*. Believing that the 2.5 multiple had become ingrained in the minds of those purchasing architectural services, the leaders of the profession suggested increasing the base. They achieved this by creating a new base, called *Direct Personnel Expense* (DPE), which was defined as the cost of the architect's employees engaged on the project and the cost of their mandatory and customary benefits.

Mandatory benefits are few and universal: Social Security (FICA) tax and workers' compensation insurance. Unless required by state or local law, virtually all other benefits are customary, but not mandatory. These include vacation, holiday, and personal time; and health insurance. Not universal, but widely recognized, are life insurance, profit-sharing plans, continuing education reimbursement, and professional dues. These mandatory and customary benefits fall in a range of .25 to .40 times salary, depending primarily on the size, age and profitability of the firm.

Using a mean of .30 for benefits, the economic structure changes substantially. The base for fee determination changes from direct salary to direct personnel expense, or $1.00 + .30 = $1.30. Using the same 2.5 billing multiple, one hour of billable time could be billed at $3.25 ($2.5 \times \$1.30 = \$3.25$). Now the profit relative to revenue is 23 percent ($.75 ÷ 3.25).

USING DIRECT SALARY EXPENSE AS THE BASE

Expense Calculation	Revenue Calculation
$1.00 Direct Salary Unit Cost	$1.00 Direct Salary Unit Cost
+1.50 Indirect Expense	×2.50 Billing Multiple
2.50 Breakeven Cost	2.50 Invoice Amount (Revenue)

Profit Calculation

$2.50 Revenue
–2.50 Breakeven Cost
0

USING DIRECT PERSONNEL EXPENSE AS THE BASE

Expense Calculation	Revenue Calculation
$1.00 Direct Salary Unit Cost	$1.30 Direct Personnel Expense
+ .30 Benefits (Included in Indirect Expenses)	×2.50 Billing Multiple
1.30 Direct Personnel Expense	3.25 Invoice Amount (Revenue)

Profit Calculation

$3.25 Revenue
–2.50 Breakeven Cost (benefits are included in Indirect Expenses)
.75 Profit

Figure 3.8 Basic Economic Structure of Architectural Practice.

At the end of its first year of practice, the basic economic structure for Able & Baker Architects was:

Expense Calculation

1.00 Direct Salary Unit Cost
+1.39 Indirect Expense Factor
(Indirect Expense ÷ Direct Salary Expense)
2.39 Breakeven cost

If Able & Baker had been able to bill each dollar of direct salary at its intended billing multiple of 3.0, its revenue calculation would have been:

Revenue Calculation

1.00 Direct Salary Unit Cost

× 3.00 Billing Multiple
3.00 Net Revenue

However, the firm incurred $72,000 in direct salary expense to generate $200,000 in net revenues (regardless of the billing method it used to bill for services). Therefore, the firm had an earned multiple of 2.78, not the 3.0 it intended.

Able & Baker Profit Calculation

2.78 Revenue
–2.39 Cost
.39 Profit

The $.39 profit the firm earned was 14 percent of net revenues. However, if the firm had used DPE as the billing base, or had been able to negotiate higher fixed fees or a higher billing rate regardless of the base, then profits could have been higher. For example, if the firm had a benefits rate of .25, then the firm's basic economic structure would have looked like this:

Revenue Base Calculation

1.00 Direct Salary Unit Cost
+ .25 Benefits Factor
1.25 Direct Personnel Expense

Revenue Calculation (using a 2.5 billing multiple)

1.25 Direct Personnel Expense
× 2.50 Billing Multiple
3.125 Billed Amount (Revenue)

Profit Calculation

3.125 Revenue
– 2.39 Cost
.735 Profit

Young firms frequently have lower benefits and total overhead ratios in the first years of practice. Moreover, they often work more than a standard 40-hour work week for their clients. In the early years at Brad's firm, they kept overhead ratio below 1.0, which enabled them to survive on the low-profit-margin projects that they often took to build the practice.

Capital Needs

Start-up capital is crucial for any new firm. Two important questions must be answered at this juncture:

- How much will I need?
- Where will I get it?

How Much?

The answer to "how much?" is a function of two different needs. First is the amount of money needed to pay for start-up organizational expenses. These might include:

- Legal and accounting assistance
- Acquisition of office space and leasehold improvements
- Furniture, fixtures, and equipment
- Printed office materials such as stationery, business cards, and transmittal forms
- Marketing materials such as announcements and brochures

To these must be added the money required to fund operations until enough cash is generated as payment for services in the normal business cycle, as indicated previously in Figure 3.1.

As stated repeatedly, it is common for architects to start a practice after developing a relationship and a commission (or the promise of a commission) that enables them to leave their current firms. The cash cycle begins when services are performed but, as explained earlier, cash payment for services usually comes in 60 to 90 days later. If the firm starts without a commission in hand, it will need to market its services, secure commissions, perform services, send invoices, and, finally, receive the first payment that establishes positive cash flow. In this case, the amount of capital required is the amount necessary to cover all disbursements that must be made until the firm begins to collect for its services.

Considering that even a firm with a project already in hand will not likely receive payment for services immediately, all start-up firms should capitalize sufficiently to cover three to six months of operating expenses, *plus* the amount needed for start-up organizational expenses.

Of course, even with work in hand, the start-up cash may not be all the investment that is required. Most new firms have very uneven cash flow in their early years. Most founders of firms can regale you with stories of their "near-death" experiences with cash flow in their early years. Brad's father, for example, recalled the weeks they were down to their last $100 (in the 1930s). They debated whether to shut down immediately and save the $100 or continue for another week. The point is, persevering is part of the history of even the most successful firms. The lesson is that having a cash reserve in the beginning and building it up over time are important to the survival of a new firm.

Where to Get the Money?

Sources for initial capital include:

- Personal savings
- Equity in personal real estate (mortgages and equity loans)
- Loans from relatives and friends
- Personal credit cards
- Small Business Administration (SBA) loans
- Commercial (bank) loans

Regarding bank loans, it is important to understand that lenders do not want to be *investors* in your firm. Their business is based on the certainty of a return on capital in the form of interest on loaned funds, rather than the uncertainty of a return in the form of profit from successful operations, which would be the right of an investor, but not a lender.

Banks will want the start-up design professionals to have some of their own capital invested in the firm, usually more than half the invested equity. Otherwise, the bank would be the primary stakeholder *and* risk-taker. Consequently, architects and other design professionals are usually required to provide a substantial portion of the necessary start-up capital from sources other than bank loans.

There are times when no commercial lenders are interested in a young design firm. Brad's firm ran into this in its sixth year, which coincided with the deep recession at the end of the 1980s. A number of the firm's developer clients went bankrupt, resulting in a cash flow crisis for the firm. Their regular bank refused to discuss a loan, and a second bank offered to loan them 70 percent of the value of cash and securities they put up as collateral.

There are two "takeaway" points from this story:

- First, it is important to establish a banking relationship and good credit early. If you do take a loan, pay it back on time. Make your banker your friend. The bank the firm finally found to help through the crisis has since proved invaluable in providing references, letters of credit required by leases, equipment leases, and many other services beyond the firm's line of credit.
- Second, it is critically important to build up reserves during the good years. Design professions are very vulnerable to business cycles. Having a supportive banker and adequate reserves of cash and credit can help get you through a downturn without it becoming a firm-threatening crisis.

To reiterate from the beginning of the chapter, seven years of plenty may be followed by seven (hopefully far fewer) years of famine.

One of the best ways to help build a strong financial base is to negotiate appropriate compensation for the services you provide. This is the subject of the next chapter.

Negotiating Fees and Contracts

4

Sales and finance come together when it is time to negotiate the fee for the services being offered. Obviously, it is essential to a firm's financial health that the design professionals learn to do this task well. All design professionals find setting fees a challenging task, especially because most clients want to know in advance what the fee will be for their project, even when the scope is unclear and the services will be provided over several years.

One approach is to do what Brad's brother-in-law did with his first client. He sent a letter of proposal for an energy audit of the client's building and left a blank for the client to fill in the fee. The client filled in $300. Most experienced professionals do not recommend this approach.

In the past this task was far simpler because most of the professions published recommended fee curves to help guide their members' efforts in setting fees. These curves have been declared anticompetitive and illegal, and the only people who still use established fee schedules are some of the large public and institutional clients. Needless to say, these

client–generated fee curves are lower than those created by the professions.

The demise of the standard fee curves was a positive step not only from a legal standpoint, but in other ways as well. These curves were built on the fallacious concept that any two projects that were of the same construction budget, building type, and mix of new and renovation would require the same effort and cost to carry out. In fact, the research done on the costs to complete various types of projects, which formed the underlying basis for the fee curves, showed widely varying results for projects that were supposed to be similar. In national surveys, for example, almost 25 percent of the projects lost money.

Projects, clients, schedules, required services, and many other factors have continued to grow in complexity since the cessation of fee schedules. This has forced the design professionals to face the fact that calculating and negotiating appropriate fees is a major task requiring considerable skill and effort.

Analyzing the Cost of Providing a Service

There are five basic steps to setting a fee:

1. Calculate costs.
2. Do a competitive analysis.
3. Do a risk analysis
4. Choose a fee method.
5. Negotiate the fee.

Calculate Costs

One method, often referred to as *top-down* budgeting, starts with the assumed or desired fee and calculates how much can be allocated to the various direct

Top-Down Budgeting

When the fee is established, either as a lump sum amount or a percentage that can be converted to a lump sum, the process used to budget the project is:

1. Start with fee dollars.
2. Subtract desired profit.
3. Yield cost of professional services.
4. Subtract cost of consultants and non-labor direct expenses.
5. Yield cost of architectural services.
6. Divide by overhead rate.
7. Yield direct salary expense.
8. Divide by average hourly rate.
9. Yield hours available.
10. Allocate hours to phases and tasks.

costs of doing the work, as shown above. Alternatively, you can calculate what it might cost to provide the service. This was documented by the AIA as "cost-based compensation" and is often referred to as "bottom-up" budgeting, as shown below.

Cost-Based Compensation ("Bottom-up") Budgeting

The bottom-up budgeting process follows this sequence:

1. Identify or estimate tasks required to execute the project.
2. Multiply by average or specific hourly rates.
3. Yield direct salary expense.
4. Multiply by overhead ratio.
5. Yield cost of architectural services.
6. Add cost of consultants and nonlabor direct expenses.
7. Yield cost of professional services.
8. Add contingency and profit.
9. Yield fee required.

Probably, the first pass at the bottom-up method will yield a higher number than the expected fee, and further analysis will be necessary to reconcile it with the top-down calculation. If and when both methods yield the same results, this can be a good starting point. Nevertheless, it is not necessarily the right fee to quote if you are still competing for the project.

Do a Competitive Analysis

The next step in establishing a fee is to research the "going rate" for the service and the fees your competitors are likely to quote. A common range for comparable jobs exists in most cases and can often be checked with other experienced firms that are not competing for the same project. This "comparing of rates" is done all the time, and a principal in either a new or established firm should not be shy about asking for advice.

Determining what your competition will charge is much more difficult. Sometimes, other firms can help you, but in most cases you have to guess at this. Established firms are likely to quote within a certain range if it is consistent with their own bottom-up and top-down analyses. Smaller, younger firms are far harder to evaluate.

Do a Risk Analysis

The next step in determining a fee is to analyze the risks. This subject, too, requires judgment, which will improve with experience. Among the most common areas of potential risk encountered on many projects are:

- *An indecisive client.* These can be hard to spot in advance, but benchmarks include: reputation from previous jobs, a vaguely worded descrip-

tion of their proposed project, and the impression they give during preproposal contacts. A client with poor decision-making capabilities always adds to the cost of providing services.

- *An unreasonable client.* Good clients expect their design team to make a profit, and will work to help ensure that happens. An unreasonable client does not care, and argues against even reasonable requests for additional compensation when the scope changes. Other clients—such as the large committees set up for some projects—are inherently indecisive even if they are well meaning. These clients often cannot be avoided, but some contingency should be built into the fee or contract to account for the extra time it takes to deal with them.
- *An extremely tight budget.* A tight budget can significantly increase the effort necessary to reach a final design. If the budget is so tight that it is unreasonable, it may be indicative of an unreasonable client. Moreover, it may make it difficult to make the proposed fee seem reasonable in proportion to the total project cost.
- *A very tight or an unpredictable schedule.* Many clients talk about unreasonably short schedules. As with budgets, if it is too tight, it may be indicative of a naïve or unreasonable client. Conversely, tight, reasonable schedules are advantageous to the design firm since many of the design team's costs increase over time. Thus, of equal concern is an indefinite schedule that stops and starts or extends beyond the time required, because many of the design team's costs are a direct function of time.
- *An interrupted work process*. Some projects are done in phases with indefinite breaks between

stages to secure financing, obtain land-use approvals, and the like. Each interruption can add to cost as a firm shuts down or remobilizes its efforts.

- *A difficult approval process.* Clients often like to shift risk. For example, if they foresee risk in obtaining financing or land-use approvals, they often will try to shift fee payments until after these hurdles have been overcome. Moreover, if these steps are risky, they are likely to require added effort by the design team.
- *Slow payment.* Some clients are notoriously slow payers. This can place a real burden on a young design firm, hence should be a factor in both the fee and the contract negotiation. To reward prompt payment, therefore, it is often worth giving something extra to a client that does so. One of Brad's first clients paid within 24 hours of receiving the invoice. This sensitivity to the firm's cash flow needs resulted in the client being given first priority throughout the life of the project.
- *A difficult construction phase.* With a good contractor or construction manager, one site visit a week is more than required; with a bad one, five days a week is not enough. As for an indecisive client, a difficult construction phase is almost impossible to predict at the beginning of a project. Therefore, it is important to clearly tie the basic fees to an assumed level of service (number of site visits, length of construction, etc.), with any overages compensated as extra services.
- *An insecure client or a client in trouble.* Many in the profession believe that the most dangerous client is one that is insecure or already in trouble. If a cli-

ent gets into financial or other difficulty, expect it to impact the design team. The only protection is to be sensitive to early signs of trouble.

Choose a Fee Method

The next step is to select the most appropriate fee method. There are many, each with its advantages and disadvantages, and no one works for all situations. The final choice often depends upon client preference. The most common are defined in the following subsections.

Percentage of Construction Cost

For decades, this was the most common method for setting fees. Its great advantage is that the fee increases automatically as the scope (as reflected in the budget) increases. Its major disadvantages are: it is arbitrary (if not based upon a project cost analysis); it penalizes the effort to contain or reduce budget, and clients view this conflict with suspicion; and the fee goes down if the cost goes down. Because of these disadvantages, this method should be used with caution, though it can be the right choice if the client has set an unrealistically low budget.

Percentage of Approved Budget

This method resolves any perceived conflict of interest. It is best used when the scope is unclear at the start of the design process.

Lump Sum

This is becoming the most commonly used method for some firms and experienced clients. If based on a careful cost and risk analysis, it can be the appropriate choice. Its major disadvantage is its underlying

assumption that the scope is fixed. Lump sums are inflexible and clients usually resist requests for extra services.

Hourly

Hourly billing is the ideal method when the scope is unclear. Most clients will, however, accept this method only for small projects or for the phases for which the scope clearly cannot be defined.

Hourly with a Cap (or Limit or Maximum)

The cap is the most common way to respond to clients' concerns about the open-ended nature of hourly billing. Some agreements permit hourly billing without an *upset amount* or fixed cap until the scope is defined and a maximum upset can be set. If a maximum, or cap, is set, it should be higher than the lump sum that could have been negotiated. In a lump sum, the design team keeps any amount under the maximum. In hourly up to a cap, the client keeps the difference. Of course, any amount over the cap is a loss to the design professionals under either arrangement.

Dollars per Square Foot or per Unit

Some fees are quoted on a unit basis (square foot, residential unit, etc.). This is common for corporate interiors, multifamily housing, and a few other building types. This is the equivalent of a lump sum if the unit total is known in advance.

Prototypes and Reuse Fees

In certain circumstances, a builder may ask the architect to design several prototypes (such as houses or chain stores) that will then be used repeatedly. In this

case, part or all of the basic cost of designing the prototype is recovered in the original prototype fee, with a smaller additional amount paid for each reuse to cover site adaptation and the rest of the prototype fee. In some cases this does not have to cover continuing services and is thus a royalty for reuse of the original design.

Performance Bonus or Success Fees

Some clients will offer bonus or success fees if certain targets (budget, schedule, etc.) are met. Since so many of these targets are under the client's control, the agreement must be clear.

Composite

Among the many other approaches to setting fees, one of the most common is to combine two or more of the preceding methods. For example, when there is a variable scope, a variable form such as hourly charges can be used for design, public approvals, and construction administration, and a fixed fee is used for the scope (usually design development and contract documents) under the design team's control.

Negotiate the Fee

Fee negotiation is more an art form than a skill, but to some extent it can be learned. The most effective teacher is experience. Absent experience, keep these basics in mind when negotiating fees:

- *Avoid setting fees while still selling.* When your priority is to be selected by the client, you may lose your focus on maintaining the fee you need. If a client asks you to set a fee during the marketing/sales process, try to build in the flexibility to

negotiate a more accurate fee later. Also, quote fee ranges rather than a single number; provide separate fee estimates for any consultants so that their fees do not distort your own proposal; and try to get the client to accept a fee *quote* for a limited initial phase of work where the scope and risks can be clearly defined. If all else fails, be as vague as possible, in the hope that it will gain you some negotiating room later.

- *Avoid setting fees before the scope has been clarified.* If a client asks for a fixed fee before the scope has been clarified, be very clear about the assumptions that form the basis of the fee. Make it plain that any material changes in the assumptions are likely to require an adjustment to the fee quotation. Refer to the risk areas discussed earlier in the chapter for the issues (such as schedule, number of meetings, scope of construction phase services, etc.) to be covered by assumptions.
- *Avoid the volitional fallacy.* The "volitional fallacy" is the assumption that because you want something to be true it will be true. Analyze your probable costs, keep and refer to records of actual costs on past jobs, and don't talk yourself into believing an unrealistically low fee will somehow work out because "this job is different."
- *Ask the client to commit to a limited first phase.* This is called "setting the hook." Once most clients have agreed to retain you for an initial scope of service, such as a site selection study or a master plan, you can usually avoid negotiating the overall fee while still competing with others. It is worth offering a very competitive fee for a limited first phase to avoid setting fees while still selling or while the scope is largely unknown.

- *Play on the client's sense of fairness.* If you think the client is fair, it's a good idea to try to make fairness a part of the negotiation. Consider sharing the underlying cost analysis that you prepared for your fee estimate. If the client asks you to cut your fee, counter by asking which part of the labor estimate they think you should cut. Most reasonable clients will not push back too hard when confronted with this choice. Some clients, even large, corporate clients, will respond favorably when faced with the fact that their unfairness is inconsistent with the company's corporate ethic.
- *Get it up front.* When setting the overall fee, try to negotiate a fee that covers the full list of known services. Some firms like to leave open the potential to negotiate extra services later, but experience proves that most clients resent this. No two clients are the same, but it is often easier to get a fair fee at the beginning rather than by detailing a long list of extra services.
- *Be prepared to walk away.* One of the easiest ways to get a fair fee is to not need the job. If you can walk away, it strengthens your negotiating stance. Unfortunately, it is rare for a new firm to be in this position. There are, however, times when even a new firm should walk away.
- *Remember, some low-fee jobs are worth taking.* As discussed in Chapters 2 and 3, there are times when it is worth taking a project for which the fee is too low; for example, if the project is relatively small, if it will lead to future work, and/or if it uses time that is uncommitted. Remember, having some income is better than none, especially for a struggling young firm.

These important points are reiterated in the box below, titled "Guidelines for Setting Fees."

Contracts and Contract Negotiation

The core of any contract is a *description of the services to be provided* and the *compensation to be paid for those services*. Most of the other clauses in a typical agreement deal with the eventualities of problems or changes in scope and compensation. At least in theory, the contract can be as simple as a handshake or a one-page

Guidelines for Setting Fees

- ➤ Don't set fixed fees while still selling or when the scope is unknown.
- ➤ Know the competition and understand the norms.
- ➤ Always estimate the cost to provide the service and define the net direct labor that will be available for the likely fee.
- ➤ Understand the areas of risk.
- ➤ Keep records and know your costs.
- ➤ Pick the most appropriate fee method:
  - ♦ Percent of construction cost (actual final cost or approved budget)
  - ♦ Lump sum
  - ♦ Hourly (open-ended or an agreed-to limit)
  - ♦ Square footage
  - ♦ Prototype and reuse fee
  - ♦ Bonuses, success fees, shared savings, and so on
  - ♦ Mixed methods
- ➤ Present the fee in the most attractive manner possible.
- ➤ Negotiate with consultants the following:
  - ♦ Consistent terms
  - ♦ Fees that work within the overall budget
  - ♦ No open-ended terms within a fixed fee contract
- ➤ Build in clear limits on open-ended scope items.
- ➤ Negotiate a fair deal up front rather than through extra services.

letter agreement. Such a limited contract is appropriate, if at all, only for very small projects or services of very limited scope. In virtually all other cases, a full agreement should be discussed and agreed upon before a project proceeds.

Whenever possible we strongly recommend that you use one of the standard AIA contract forms as the starting point for an agreement. These standard forms are usually modified to reflect the specific understandings between the owner and the design team. That said, you will also find that some clients have their own standard forms, and that some overenthusiastic client attorneys insist on rewriting the standard forms. Beware of these other standard forms and major rewrites because they are usually one-sided and contain clauses that can create unacceptable risks for the design team.

Some of the more common issues encountered in negotiating the standard clauses of an owner-architect agreement (such as AIA B-141—see the box on the next page) are as follows:

NOTE

It is beyond the scope of this book to cover all aspects of the typical contract negotiation, and none of the information in this section should be considered legal advice. When in doubt about the legal implications of any contractual issue, consult an attorney with relevant experience, your liability insurance carrier, or another design professional with substantial experience in contract negotiation.

Contracting Parties

The contract usually begins by naming the parties to the agreement. Note here that you want the client to be an *entity with assets*. If the client signs the agreement in the name of a shell corporation, the design team may have no recourse in the case of a dispute over money.

The Project

The description of the project (the program, the concept, the schedule, etc.) is important because it sets a baseline against which to judge whether the client is making material changes after the fee has

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been set. If there is a written program, a schedule, concept drawings, or other descriptive material, attach them as exhibits to the contract.

Scope/Services

This section of the contract should be modified to:

- Reflect the services to be provided.
- Clarify for an inexperienced client the design team's role.
- Establish limits or assumptions for some of the major variables.

For example:

- If the design team is to develop the space program, develop studies of possible future phases, negotiate special land-use approvals, or provide a full-time on-site representative during con-

struction; these services should be included in Article 12 or in a modified Article 1 in the B-141 form. The description of the scope of services in the standard form is too generic to be good for either the client or the design team.

- If the owner does not understand what your responsibilities are (versus those of the builder, the interior designer, or the owner), it is worth clarifying these up front. Too many client relationships deteriorate when the owner learns—after the fact—that the design team does not have control over the construction subcontractors or that essential services were not included in the agreement.
- If consultants will be included as subcontractors to you, make sure they agree to the same terms that bind you. It is particularly important that they agree to be paid only after you are paid, that they have insurance, and that they do not take exception to any of the contract terms.

Additional, Optional, or Contingent Services

The standard form provides a checklist of some of the more common reasons for additional services. Be clear how such services will be authorized. If a client wants to approve additional services in writing and in advance, be careful not to proceed without this written authorization. In addition, make sure this list includes any changes in the assumptions (number of site visits, etc.) that form the foundation of your fee quote. In some areas you may want to agree with the client that you will include a stated amount of time (say, 100 hours) in your base fee for analysis of change orders and contractor substitutions, and charge only excessive time as an additional service.

Construction Costs

Do not guarantee the construction costs. At the same time, make sure that if cost is the basis for the fee, the estimate is realistic and contains everything, including the CM fee and any contingencies.

Ownership of Documents

Owners often insist on removing this clause, though usually it is possible to get clients to agree to accept copies for their use. If the clause is removed, you should be aware that you may be losing rights otherwise provided to you under federal copyright law. In addition, you should insist on a clause that holds you harmless from any reuse of the documents. When liability problems arise in a future addition, the plaintiff's attorney will sue everyone on the title block.

Arbitration

Most owners strike this clause, which you may find acceptable. It is, however, worthwhile to insist that disputes be subjected to at least nonbinding mediation prior to any litigation.

Termination

Owners like to strike termination clauses. While there are some valid arguments for protection from arbitrary termination and for reimbursement of costs, most owners refuse to pay even if the clause remains. Therefore, these clauses are often sacrificed in exchange for keeping other clauses.

Payment

Insist on monthly billing and timely payment or the right to stop work if payments are not made.

Payments Withheld

To the extent possible, make sure that the client understands that achieving perfection in the drawings and services is an unrealistic standard, and that some change orders, omissions, and problems are inevitable. Discuss a reasonable change-order contingency during the initial budgeting phase of the project, as well as during the contract negotiations.

Too many clients believe in a different golden rule: that is, they have the gold so they make the rules. Make it a mutual understanding that if they arbitrarily withhold payment, you can stop work.

Basic Compensation

The best advice for this key section of the contract is to get advice on how to fill it in. But, basically, the following points are essential elements of the contract and should be clearly documented:

- Most owners object to markups on consultants and reimbursables, but such markups merely reflect the real liability and administrative costs of including these expenses in your contract. One device that usually helps bring this point home is to give the client the opportunity to retain consultants directly (so that they incur the extra administrative and liability burden and no longer have your liability insurance covering the consultants). They will almost always refuse.
- Owners will rightly ask for prior approval in writing for additional services. Agree to this, but always insist on getting approval in writing before you *provide* the services.
- The rate of interest is often listed as the legal rate since some states limit the permissible rate.

Other Provisions

This is the section where all other understandings should be documented.

With work in hand, it is now time to focus on how the firm should be organized. This is the subject of the next chapter.

Organization and Personnel

5

All firms grow to be a reflection of their founders, in part based on interests and abilities, and in part due to how the founders choose to organize their practice. A principal committed to a *strong idea* practice will make different organizational choices from one committed to a *strong service* model. (This is discussed more fully in Chapter 9 and in Appendix B, Charting Your Course.)

Legal Forms of Organization

Even if the new firm will be staffed by only the person starting the firm, that person should decide on the nature of the organization he or she is launching, following the guiding principles given in the box titled "Basic Organizational Principles." The most common options are:

- Proprietorship
- Partnership
- General (business) corporation (C-corporation)
- Professional corporation (P.C.)

- S-corporation (strictly speaking, the S-election in a business corporation)
- Limited Liability Company (LLC) or Limited Liability Partnership (LLP)

Unless there is a specific reason to do otherwise, it is advisable to begin practice in the simplest, most economical, and most flexible organization, keeping in mind that eventual change may be desirable and will be possible. Regardless of the form, think of the practice as a separate entity with its own requirements, organization, procedures, and accounts. Each of the organizational forms is described in the following subsections.

Proprietorship

A *proprietorship* is an entity in which the firm and the individual who owns it are synonymous. All revenues and expenses of the business are treated as if they are the personal revenue and expenses of the proprietor who is the 100 percent owner.

It is generally possible and permissible, but it is not advisable, for proprietors to run their businesses through their personal checkbooks. In theory, a proprietor of a design firm, even one with employees, could deposit clients' payments into his or her personal checking account, and from that account disburse payments for salaries, taxes, and other company expenses, thereby effectively merging personal and company accounts. This practice should be avoided because it is likly to obscure the operations of the firm and increase the risk of incurring serious tax problems. Even though, in the final analysis, the firm's income is the proprietor's personal income, and even if the start-up firm is small, a pro-

Basic Organizational Principles

- Design professions are team sports. Few people are good at everything, and most successful firms are led by principals who possess a balance of the essential design, technical, management, and marketing skills.
- The roles and personal goals of a firm's leaders must mesh.
- Agree on the strategic goals, but expect diversity in tactics and short-term objectives.
- Look for strength in your colleagues; you don't want weak subordinates.
- Most new firms with more than one leader operate as if they were partnerships even if they use another form of organization.
- Partnership is an inherently difficult form. Mutual respect, a commitment to make it work, and trust are essential.
- When selecting and documenting the firm's organization, seek professional advice on the legal options, decision making, initial contributions of capital or other assets by the principals, distribution of profits and losses, changes in ownership, departure (forced or voluntary) of the owner, retirement, death or disability, dissolution of the firm.
- People are not fungible or expendable; they are a firm's most important assets and should be treated that way.
- Growth demands organizational change.
  - 1→2 Adding an employee or a partner is the most fundamental change.
  - 8→12 An informal start-up must become a "firm."
  - 20→30 The founder can be involved in everything but cannot run everything.
  - 25→60 The founder cannot even be involved in everything.
- Plan for eventual transition or change of ownership—begin to look for your successor right from the beginning.

prietor should open a separate checking account to record just the firm's transactions.

For a design professional starting very small, it is reasonable and perhaps even advisable, to start as a proprietorship. The advantages outweigh the disadvantages. A proprietorship:

- Is simple to begin and operate.
- Requires no special legal creation and may not require business registration.
- Requires no special personal tax filings, since the firm's taxes are the proprietor's.

The singular disadvantage is that the proprietor's personal professional liability is limitless, as it would be in any other form of organization in which the individual was the sole owner.

Partnership

Some new firms, as is our case study firm, Able & Baker, are organized by two or more professionals who elect to form a firm together as equal (or unequal) coowners. In this circumstance, the most common organization chosen is a partnership. Unlike a proprietorship, a partnership is a legal entity unto itself. Although it is strongly advisable, it is not required that professionals entering into partnership execute a partnership agreement that defines the particular conditions they want to apply to their new firm. If they choose not to, their partnership will be *understood* to be operating, and disputes will be resolved in accordance with the conditions of their state's uniform partnership code.

Following are the most important issues to consider in establishing a partnership agreement:

- *Initial investment:* Who will be contributors and in what proportions?

- *Additional investment, if needed:* Who will provide it, and in what proportions?
- *Distribution of profits and losses:* These are generally in proportion to ownership interests, but should be spelled out.
- *Decision making:* By dictate, vote, or consensus? If by vote, vote of individuals or shares?
- *Valuation* (and decision making where appropriate) for death or permanent disability, normal retirement, voluntary early withdrawal, and involuntary separation.
- *New owners:* Who decides whether and whom to bring in as additional owners?
- *Noncompete provisions:* If owners leave the practice, what limits are placed on their ability to compete with the remaining owners?
- *Expectations of owners:* What particular commitments are required? Is it full-time? Does all professional income go to the firm?
- *Sale to others:* What conditions apply to a prospective sale? Who decides?
- *Liquidation of the practice:* How is it decided, and by whom, to terminate or liquidate the practice?

Because a partnership is a legal entity disconnected from the personal circumstances of the partners, financial records must be kept that identify the partnership's revenues, expenses, and profit or loss. The tax effect, however, is that profits (*net income*, in accounting terms) or losses "pass through" the partnership and are allocated to the individual partners in proportion to their ownership interests. The partners, therefore, assume personal responsibility for federal, state and local income taxes on their allocated portion of partnership income.

In a *general partnership*, liability extends to the partners, "individually and severally," meaning that each partner is responsible for 100 percent of the liabilities of the partnership. That condition precipitated the enactment of laws permitting professional practice in limited liability partnerships (LLPs) or companies (LLCs), described later.

General or Professional Corporation

A *corporation* is a legal entity owned by its stockholders or shareholders pursuant to a certificate, or articles, of incorporation and bylaws, which it must file in the state in which it is organized. In a typical corporation, a design firm's professional, technical, and clerical staff, including the shareholders, are all considered employees of the corporation. Shareholder employees receive salaries, from which taxes are withheld and filed by the corporation.

Corporations must keep separate financial accounts and records. And because corporate income (profit) after all expenses, including salaries and bonuses, is taxed at corporate income tax rates, and because dividends distributed to stockholders are also taxed, corporate owners generally choose to distribute profits in the form of bonuses in the year in which they are earned.

Liability of shareholders in general corporations is limited to their proportionate ownership share in the company. For that reason, many states prohibit the practice of architecture and other design professions in corporate form, because they want *professional* liability to extend to the responsible professionals, regardless of their level of ownership. Consequently, several states have enacted a new corporate form—the *professional corporation*—to allow design professionals to enjoy the business benefits of corporate practice while

maintaining their professional responsibilities in the public interest. Professional corporations (PCs) generally differ from general corporations in that professional liability in PCs extends to those professionals in the corporation found to have been responsible for a professional error or omission; in most other ways, PCs are like general corporations.

S-Corporation

The *S-corporation* (more strictly, the S-election available within general corporations) is a corporate form closely following the requirements of more traditional corporate forms, but treating the shareholders as if they were partners in a partnership for tax purposes. In that way, income or loss flows through the corporation, which has no liability for taxes, and is allocated to the shareholders in proportion to their share ownership.

Limited Liability Company or Partnership

Responding to a situation several years ago in which the acts of partners in a satellite office of a national accounting firm (organized as a partnership) were found to be fraudulent, resulting in the eventual collapse of the company, several states enacted laws that permitted professional practice as a limited liability partnership (LLP) or limited liability company (LLC). An *LLC* is a legal entity distinct from its owners, who are called "members" and who own membership interests in the LLC.

These entities typically combine the management flexibility and tax advantages of general partnerships, with the liability protection of a corporation. More specifically, the members in an LLC have business liability only to the extent of their membership inter-

TIP

Remember, unless there is a specific reason to do otherwise, organize your practice in the simplest, most economical, and most flexible way possible.

est in the company, likewise professional liability only for their own professional acts and those for which they had supervisory responsibility.

Professionals forming an LLC typically file a Certificate of Formation with the state, and operate the company pursuant to an Operating Agreement that is similar to a General Partnership Agreement. Like a partnership, an LLC permits pass-through taxation to its member owners with no entity-level tax.

Project and Firm Organizational Structures

Most firms start small with one architect serving one client—although there certainly are exceptions, including some notable ones. When you start small, the project and firmwide organizational structure looks as shown in Figure 5.1.

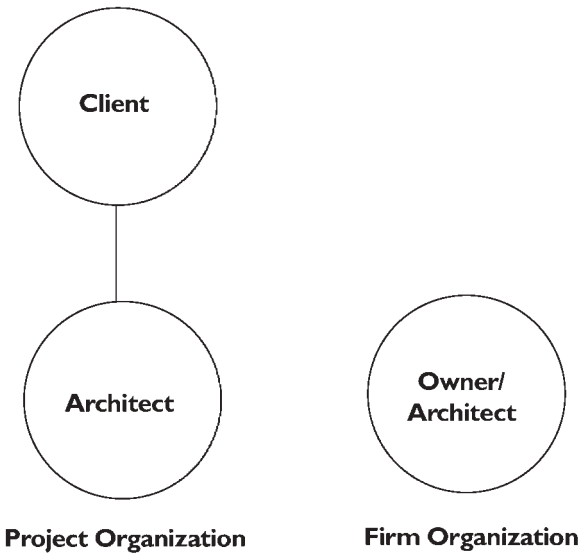

Figure 5.1 Project and Organizational Structure for Small Start-up Firms.

On projects, the sole proprietor—the architect—forms the client relationship; negotiates the owner-architect agreement; establishes the program; designs, documents, checks shop drawings; visits the job site—in fact does everything that needs doing on the project. It's the same for the firm: that same person plans, markets, manages, and administers, in short does everything that needs doing for the firm, as a whole.

As the demands on the owner-architect's time increase, eventually becoming greater than he or she can reasonably handle, the owner-architect will hire an assistant to help with projects, administrative matters, or both. At that point, the project and firmwide structures will change, as shown in Figure 5.2.

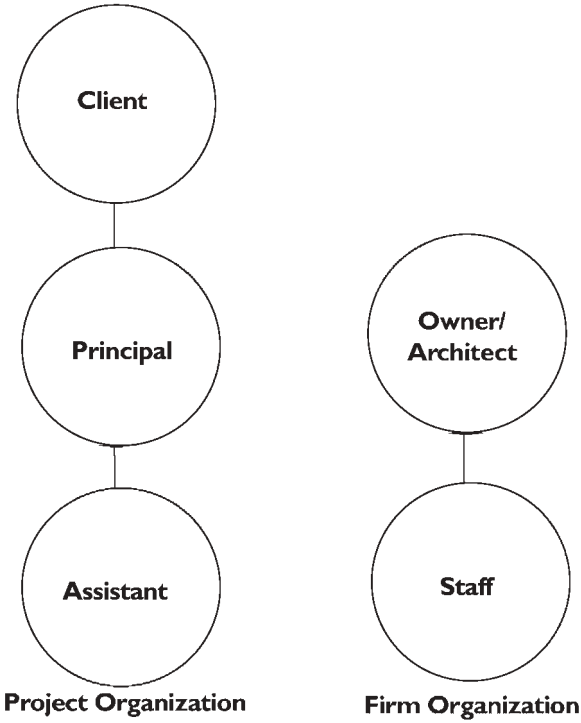

Figure 5.2 Project and Firmwide Structure after Modest Growth.

As client and project loads increase gradually, the owner-architect is likely to replicate the project structure, maintaining his or her direct relationship to the client, initiating the project and assigning to his or her professional/technical assistant the tasks that he or she chooses to delegate because he or she has less interest or insufficient time to accomplish them.

If, however, the client/project load increases dramatically, that solution may become impractical. Clients require the attention of the firm's principal; but if the client's need for attention exceeds that which the principal can provide, something has to give. Either the principal must delegate more responsibility for client contact to his or her professional assistant, or the principal must add another staff member capable of doing what he or she does; that is, the owner-architect must take on a partner.

If the principal opts to delegate some of his or her responsibility to an assistant, the project structure will again change, to resemble the one shown in Figure 5.3. This diagram displays a structure in which

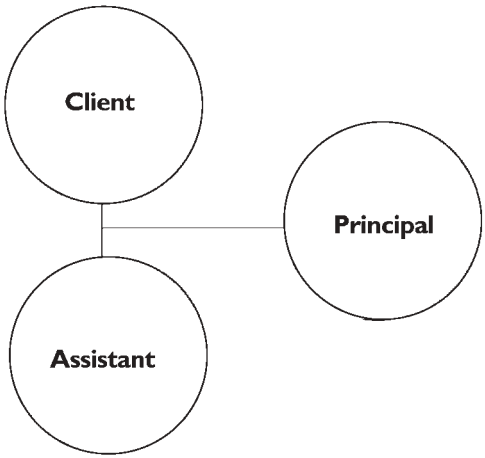

Figure 5.3 Project Structure after the Addition of an Assistant.

the usual role of the principal is to get the job, negotiate the contract, assemble the internal and external project team (i.e., staff and consultants), and initiate the project. Thereafter, the principal assumes as much responsibility and control that he or she can, given his or her other tasks, and delegates the rest to the staff. The assistant (who may fill the role of architect, staff architect, or project architect, and on larger projects with larger project teams, project manager) meets those responsibilities delegated to him or her, normally in design and documentation, though sometimes in project management and construction administration, as well.

In addition, since the organization is now composed of two professionals, but no administrative/clerical support, either the principal, the professional assistant, or both must also take on the administrative/clerical tasks necessary to keep the firm functioning. These include a wide range of activities, including receiving visitors, answering the telephone, preparing correspondence and invoices, keeping personnel and financial records, paying bills, remitting taxes, maintaining the physical plant and equipment, providing marketing assistance, and many others.

TIP

The farther down the line of command that a task can be delegated and performed effectively, the better managed the firm will be.

However, the architect may choose to resolve the workload problem by adding a partner, in which case it is likely that each principal will become the principal-in-charge for his or her own projects. The project and firmwide structures change (see Figure 5.4) to reflect the addition of a second owner with responsibilities as described, in which case, the partners run the firm together, either dividing firmwide responsibilities between them or conferring on all matters, probably making decisions by consensus.

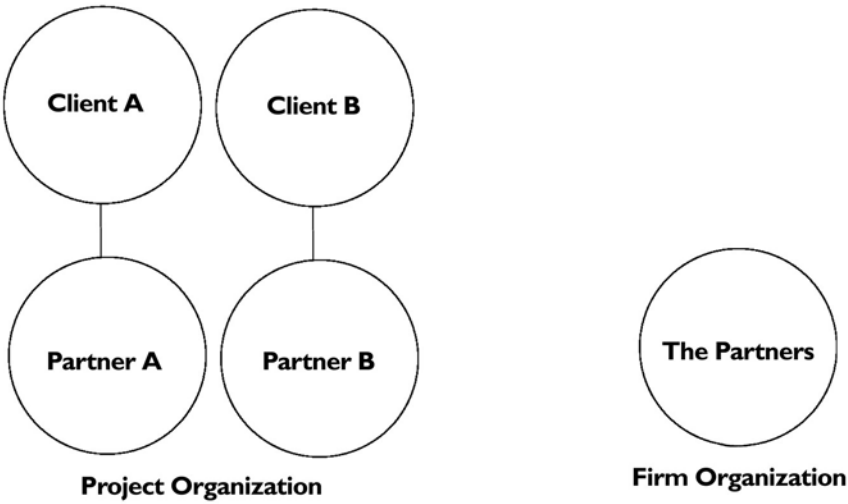

Figure 5.4 Structure Showing Addition of a Partner.

As the firm continues to grow, the same issues arise, albeit on a larger scale. The likely result will be that the partners will add staff to assist them in meeting both project and firm needs. But until the firm becomes substantially larger, the project staff will probably be organized as a series of ad hoc teams that form and re-form as necessary to meet changing client/project needs. The structure of those teams will likely resemble those shown in Figure 5.3 or Figure 5.4, depending on whether or not the principals have added staff to assist them to execute projects. In contrast, the firmwide organization may become more specific to meet certain functional needs, particularly those related to marketing, finance, and administration, specifically, bookkeeping, invoicing, and control of accounts receivable, accounts payable, and cash flow. The firmwide organization will then look like that shown in Figure 5.5.

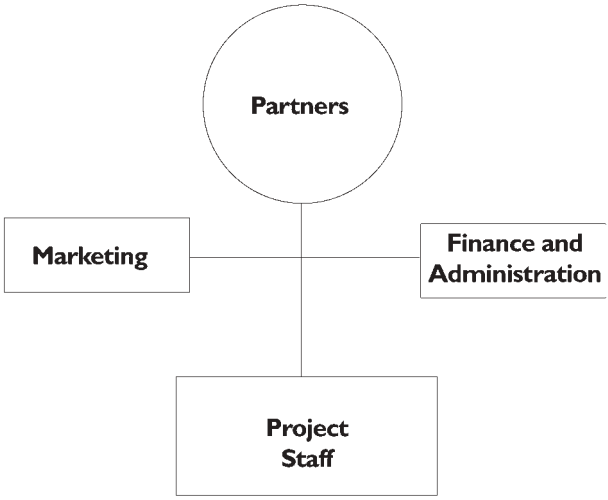

Figure 5.5 More Specific Firm Organization.

Growth Plateaus

When the firm's project workload and revenues first begin to grow sufficiently to require assistance, but not enough to add more than one person, the principal must make a choice between adding a professional/technical or clerical/administrative person as the firm's first employee. Hiring the first employee marks a plateau reached by the firm. Previously, the owner was likely functioning as a proprietor, responsible only to and for him- or herself, and accustomed to paying for the firm's operating expenses and keeping and paying personal income taxes on the monies remaining as the difference between project revenues and direct and indirect expenses. The addition of the first employee changes all that.

First Hires

As explained earlier, the first growth plateau for a new firm occurs when the founder hires his or her

first employee, the need for which arises when the project load becomes too great for the founder to execute without assistance. Hence, the founder begins to seek a person whose primary role will be to assist in executing projects. But what level of assistance? Does the principal need a brilliant designer? A highly skilled CAD technician? A well-educated but minimally experienced recent graduate? The answer must be made after considering both the immediate need and the longer-term direction of the firm.

If the founder is developing a "strong idea" firm—one organized to deliver singular expertise or innovation on unique projects, or to solve one-of-a-kind problems for "patrons"—then the founder's first hire will have to come from among "the best and the brightest," a talented, young professional who will join the firm to work with the "guru" who is creating those innovative solutions on which the firm is building its reputation.

If, instead, the firm is being developed as a strong service firm—one that delivers experience and reliability, especially on complex assignments with high management components and difficult approval procedures—then the founder will want a well-balanced, career-oriented professional with a strong commitment to client satisfaction.

Or, if the founder's objective for the firm is to provide highly efficient service on routine or even repetitive assignments for clients who seek more of a standard product than a service, then the best first hire will be someone who is committed to getting the job done efficiently and who is comfortable using standardized procedures to do so.

All that said, the best first employee may not be a project assistant at all. The best choice might be a

clerical/administrative assistant who can free the founder from administrative duties that take him or her away from his or her primary responsibility: obtaining and satisfying clients.

An important management principle, well proven in practice, is that the best way to manage a firm is to delegate every task to the lowest member of the hierarchy who can execute it effectively. Thus, if the founder can delegate bookkeeping, record-keeping, invoicing, or even routine marketing and collections tasks to a competent clerical/administrative assistant, then he or she will have more time to seek new clients and satisfy current ones. Such an assistant could come from the clerical ranks, a secretary or bookkeeper, for example, with experience in the profession and the necessary interest and ability to take on more responsibility. Or that person could be a recent graduate, perhaps with a degree in marketing or business administration, with little experience but with enough intelligence and drive to learn quickly. Either way, the founder will free up time to devote to clients and projects.

If a firm's workload is growing fast enough to require assistance, but not fast enough to afford someone full-time, the founder can often hire, on a temporary basis, quality personnel that would otherwise be unaffordable to them on a full-time basis. Many cities now have agencies that provide such temporary professional staff. Their ranks are composed variously of highly qualified professionals or technicians between permanent jobs, those who prefer the flexibility afforded by semipermanent jobs, or those who prefer the challenge and novelty of a changing work environment.

Another option is to establish a *cooperative venture*. In this arrangement, professionals without immediate interest in, or prospects for, growth in the near term, pool their talents, energies, financial resources, and office space to provide project assistance to each other on an as-needed basis.

The addition of the first employee, whether professional/technical or clerical/administrative, automatically gives the owner-proprietor a new role, that of employer, with responsibility for meeting a limited but important list of requirements: income tax withholdings and remittances on the employee's compensation, FICA (Social Security) tax payments, worker compensation taxes or insurance (depending on the state in which the firm practices), and OSHA-monitored health and safety conditions.

If the principal has carefully considered the workload and financial conditions (both profitability and cash flow) leading to the decision to add an employee, and if the principal keeps a finger on those pulses, formally or informally, then the added responsibilities attendant to becoming an employer will not be overwhelming and the rewards will mount.

As stated previously, an important management theory, one proven in practice, is that the farther down the line of command a task can be delegated, and performed effectively, the better managed the firm will be. By adding an assistant, the principal can now delegate tasks, freeing him- or herself to use those skills that he or she uniquely provides. In effect, a structure has been created that enables the principal to function at his or her highest level, hence be most effective for the firm.

The growth of a firm can be seen as a series of numerical plateaus, as delineated here:

1+1
1+1 partner
10 people
25–35
50–60
100

The first plateau, 1+1, refers to the founder plus the first employee.

The second plateau, 1 + 1 partner, means the firm was not founded by two partners (two relatively equal owners regardless of the legal entity in which they choose to operate). This plateau occurs when the firm's work has grown to the point which the single founder cannot comfortably, or chooses not to, handle alone. At that point the founder brings in a partner or elevates an employee to partner.

The third plateau occurs if the founder has not already brought in a partner and the firm grows to about 10 or 11 staff members. This is also the point at which a new office will start to have the appearance of an established firm, with regular hours, multi-person teams, marketing materials, and professional accounting support. The economics of the field of architecture and similar professional design firms generally preclude the addition of staff without projects for them to work on, so firms add staff in response to project requirements, usually when the firm wins more projects, or larger projects, and/or more complex projects. When this occurs, the sole principal usually finds him- or herself with more than he or she can conscientiously address—more clients and more team members requiring his or her

attention on projects, and more firm management issues to resolve, particularly those resulting from increases in clients, projects, and staff.

That size is reached when the number of staff the principal must manage exceeds his or her reasonable realm of control. In architecture and similar professional service firms, the normal control ratio—of principals to staff—runs from 1:7 at the low end to 1:11 at the high end. In most circumstances, when the ratio of staff to principals (defined here as those in the firm who do what principals normally do to ensure the success of the firm, including capitalizing the firm, securing new work, managing at the top, establishing acceptable quality levels, and providing necessary leadership) exceeds 11:1, the lone principal will likely feel the attendant stress from having too much to do, and will begin thinking about adding a partner.

The fourth plateau is typically reached when the firm grows to 25 to 35 people. At that size, the staff will likely have become more diverse, and a layer of intermediate staff will have been identified. Initially recruited or elevated to assume higher-level project responsibilities, such as project manager, these people are also the most likely to have their elevated status recognized in a title such as "associate." Although they may not be designated as managers per se or have substantial management responsibility, they constitute a "middle management" level that the firm must have to operate successfully. They fill the gap in experience and capability between the principals at the top and the junior staff below. Thus, the senior staff develops and manages projects, thereby freeing the principals to perform where they're most effective, at leading, directing, and mentoring.

In addition, senior staff may seek and/or be given other firmwide responsibilities, because the firm will have grown to the point at which certain centralized functions are necessary to improve its effectiveness. For example, the principals may need assistance in marketing, creation of administrative policies, development of firmwide project standards, and the like. Who better to call on and involve than the most experienced people?

The fifth plateau is reached when the firm grows to about 50 or 60 people and requires full-time management, again largely as a direct result of its project load. Until that point, the firm will likely have been managed by the principals, who assume collective responsibility for the firm and individual responsibility for various firmwide functions, such as marketing, finance, recruiting, professional development, physical plant, administrative staff, and so on, with each principal spending a small portion of his or her time "running" the area assigned. When the firm reaches the fifth plateau, it will likely require full-time management, generally in the form of a single person who may be called managing partner, president, CEO, general manager, director of operations/operations manager, COO, or the like. Depending on the values of the principals and their need for, and comfort level with, focused responsibility, the singular manager may be directive or facilitative in nature, but will likely to spend the great majority of his or her time running the firm, as opposed to running projects.

The sixth plateau is reached when the firm grows to approximately 100. Up to that point, the firm's project operational structure may have been composed of a series of project teams that come together

to execute a project, then disband and reform in other project teams to execute other projects. By the time the firm has reached 100, if it has not already done so for market or project delivery reasons, it will probably implement a substructure of some kind between the entity of the firm and the project team so that the staff have a "home" in the firm; that is, they know where they belong. Based on the values of the owners, the leaders will decide on the substructure that will best address the issues at hand: studios, departments, studio-department combinations, or matrix organizations.

Care and Feeding of Partners

Unless the firm stays very small, either by choice or circumstance, the founder will typically choose to have one or more partners, and one of the most complex aspects of running a practice is the caring and feeding of partners. Regardless of the organizational form of the firm, the interrelationships among principals can be either a foundational strength or a fatal weakness.

Both of us have had many partners and have helped mediate partner relations in many other firms and have come to the conclusion that mutually supportive teams of principals create far more successful firms than any one of the principals could have achieved alone. Conversely, problems between principals have caused significant damage to a firm's future.

Partnerships between unrelated individuals have been compared to marriages without the "glue" of children or sex. As with marriages, it is hard to specify the secrets to successful partnerships, but some general guidelines can be established:

- You do not have to be close friends (although it helps), but you should like and respect each other. It usually takes more than a partnership or shareholders' agreement to hold a group together.
- Do not expect every principal to put in equal effort or achieve equal results. That is the ideal, but it is unrealistic. Instead, ascertain whether each individual is filling a principal's role and making a principal-level contribution to the firm's success.
- Be wary of inherently unstable situations. Among the most common is a husband and wife with a third partner. Several third partners in famous firms have not survived the dynamics of this combination.
- Respect diversity. Most really successful partnerships have principals with complementary personalities and skills who respect the different capabilities of their partners.
- Even weak partnerships can appear successful in good times. The real test of a partnership is how it holds up under adversity.
- Strive for fairness in the allocation of financial distribution, professional credit, and the other rewards of ownership. Seemingly minor differences or omissions of credit can be very disruptive.
- Put in writing the basic understandings of the shareholders' or partnership agreement.
- If it is not working, end it. If a partnership dissolves, make every effort to avoid litigation or the other typical nastiness of a divorce. In the long run, it is far better to get it over with, as quickly and cheaply as possible.

Project Delivery Process

The project delivery process is an important aspect of a firm's design operations. The process the firm puts in place to execute projects and how it delivers projects to its clients affect every area of its practice.

The project process includes these aspects:

- Team organization
- Project schedule and deliverables
- Roles and responsibilities
- Accountability for decisions

There is no one right way to organize and schedule projects, nor is there one right way to assign responsibility or accountability. Rather, there are many variables to consider, including project location and scope, project schedule and compensation, and staff ability and availability. The best advice is to consider each project situation as unique within the context of a process that is flexible enough to be applied differently for each unique situation. The objective is to determine individual solutions for each specific situation, within a project process that is consistent for the firm as a whole, and consistent with its goals.

The prototypical process has four steps:

1. Identify the project delivery unit.
2. Prepare a project process chart.
3. Define each person's functions and duties.
4. Assign ultimate decision-making responsibility.

We'll go through each of these steps in detail.

Step 1: Identify Project Delivery Unit

The project delivery unit refers to the individual, project team, department, studio, or some combina-

tion of those used to execute projects. Each firm will establish its preferred method of organizing personnel to deliver projects to clients. If, for example, the firm starts as a single proprietor with no staff, the project delivery unit will be the proprietor, who will perform all project tasks. If the proprietor adds staff to assist, then certain responsibilities will be delegated.

Regardless of the delivery unit, each must accomplish the design, technical, and managerial aspects of completing projects in accord with the owner's (or owners') preferences. The involvement of the owner(s) can vary within a unit type, depending on the client, the project, and the size and capability of the firm at that point in time.

It is important to think about your delivery unit choice early because it will influence many important aspects of your practice, including, at the very least, the way the principal will spend his or her time, the choice of staff, and the economics of the practice. Also, as a firm moves through the growth plateaus, and evolves, the organization and processes will likely change and require new thinking.

In a principal-led team, the principal typically maintains overall authority for project implementation. Little essential responsibility or authority is delegated to key staff members below the principal level. Rather, the principal retains responsibility for actively running the project on a day-to-day basis. That said, to increase his or her span of control, the principal may delegate significant project responsibility to key people below the principal level, while retaining overall project supervisory responsibility. This, of course, is the typical structure of a new firm, but the principal of a firm of any size that is planning

to grow or to take on larger, more complex projects should understand that this project leadership structure will likely change over time.

The options of principal-led teams include:

- A *project architect-led team* structure places prime responsibility and authority in the hands of one person who has overall project responsibility and is expected to make both design and management decisions on a day-to-day basis, communicating with the principal in accordance with a protocol he or she has established.
- A *designer-led team* structure places prime responsibility in the hands of a designer, who may have a subordinate manager, or subsumes those management functions.
- In a *project manager-led team*, prime project responsibility and authority are placed in the hands of a manager, who may have a subordinate designer as part of the project team.
- A *co-equal designer and manager team* has managerial and design responsibilities assigned to two persons (e.g., a project manager and project designer) who have equal authority but different responsibilities. In such structures, it is common, and usually required, that the two key people agree on decisions affecting both project design and management.
- *Manager-led departments* that concentrate on specific aspects of the work, such as design and production, are often established by firms seeking to maximize design and technical efficiency. In such structure, a partner-in-charge or project manager represents both the client's and the firm's overall interests and shepherds

the project through the firm's departmental system. Often responsibilities are shared, with the manager responsible for the program and schedule and department heads responsible for design and technical quality.

- *Studios* are often organized to focus on specific markets or project types, (e.g., a commercial or healthcare studio), especially where the market, client, and/or projects require specialized knowledge and technical skills. The studio staff may have developed special interest and knowledge of the kind of work on which the studio is focusing, or may be generalists who are assigned to the studio for a specified period of time.

Combination structures (such as those structured as studios at the top and departments at the bottom) are organized to take advantage of the need for specialization and efficiency.

There are pitfalls inherent to each of the prototypical structures:

- Principals who elect to retain day-to-day responsibility automatically limit their availability to assume other important responsibilities in the firm. They also limit the number, and perhaps size and complexity, of projects that the firm is capable of executing. And, finally, the potential growth of junior professionals of the firm is limited because there are no supervisory project positions into which they can grow.
- Firms that choose to organize projects in architect-led teams often do so to increase the principal's span of control, while keeping a generalist at the project helm. However, as workload increases, these architects (some-

times called project directors or architects-in-charge) may find themselves deluged with managerial and administrative tasks, thus less and less involved in the actual design and technical development of projects, which may have been the reason they and the firm elected such a structure in the first place.

- Firms interested in the primacy of design often will want a designer to lead the team, but a dilemma arises if the designer finds him- or herself unwilling, and sometimes unable, to deal with expanding managerial and technical project needs. Or, if the designer is able to undertake those responsibilities, he or she may become less available to address the design issues that are important to both the designer and the firm.
- Manager-led teams are usually formed because there is an emphasis on both the client's and the firm's management needs (such as budgets and schedules). The danger with this structure is that managers may fail to realize the level of design achievement desired by the firm. In this situation, it helps if the manager has not only basic architectural experience and basic managerial skills—planning, scheduling, budgeting—but also the interpersonal skills important to effective management—communication, negotiation, delegation, and team-building.
- The co-equal designer and manager team would appear to solve the problem of the manager-led team, but this organizational structure requires not only firms that are large enough, and with enough projects, to necessitate and support double leadership, but also clearly defined limits of responsibility and solid working relationships.

- A departmental structure achieves efficiency by focusing knowledge, effort, and energy on narrower tasks, but often at the expense of broader project understanding and continuity of decision making. And for this structure to work, the apparent conflict between the project manager's responsibility for the "what" (program) and the "when" (schedule), and the department head's "who" (staff) and "how" (design and technical procedures and quality), must be resolved, which requires a clear delineation of responsibilities at all levels.

Each firm must choose an organizational structure that meets its needs. Start-up *strong idea* firms will be most effective beginning with single-point leadership—an architect or designer with responsibility for all aspects of the project. Start-up *strong service* firms will be most effective beginning with project teams led by capable management—a principal, project manager, or architect who is clearly focused on the management needs of the client and project.

Step 2: Prepare a Project Process Chart

A project process chart shows the percentage of time expended by role and phase. It identifies the deliverables to be provided and indicates the level of project profitability (see Figure 5.6).

When the firm starts in practice, the projects are likely to be small in size, simple in scope, and executed by the principal. When only one person's time is involved, it should be relatively easy to plan a new project by identifying the tasks to be performed in each phase. Even if the project is of a type unfamiliar to the architect, making it difficult to estimate the

	Phases					
	Predesign	*Schematic Design*	*Design Development*	*Construction Documents*	*Bidding/ Negotiation*	*Construction Adminis-tration*
Percent of Total	%	%	%	%	%	%
Deliverables						
	Roles					
Principal-in-Charge	%	%	%	%	%	%
Project Manager	%	%	%	%	%	%
Project Designer	%	%	%	%	%	%
Project Architect	%	%	%	%	%	%
Drafter/ Technician	%	%	%	%	%	%
Other	%	%	%	%	%	%
	100%	100%	100%	100%	100%	100%

Figure 5.6 Project Process Chart.

time per task, he or she can estimate the overall time in each phase of the work, understanding that all necessary tasks must be accomplished within that time frame.

As the firm develops experience over time, the principal will be better able to identify the amount and percentage of time necessary to accomplish particular tasks, on "typical" projects and on all projects. Going further, the firm will be able to identify how

that time was expended on a task-by-task basis in each phase. From this information, it will be possible to prepare a pro forma project process diagram that can then be adjusted on a project-by-project basis to reflect the conditions of a particular project.

For example, experience might show that the firm typically expends 10 to 12 percent of total project time in schematic design, of which 40 percent is allocated to a project manager, or project management activities; 40 percent to a project designer, or project design activities; and 20 percent to an assistant designer, drafter, or CAD technician (for documentation activities in that phase). The result is usually a schematic design package of a site plan, ground floor plan, floor plan for each level, sketch elevations, and a three-dimensional representation of some kind.

Based on its experience, it might become clear to the firm that the review and approval requirements of the new project will require an unusually high level of management effort to successfully shepherd the project through to completion and acceptance by the owner, the local planning board, and other review groups. At the same time, the project might be deemed to require at least twice as much design effort as the firm's norm. In this case, early identification of these issues would enable the firm to schedule and prepare interim presentations to serve multiple purposes and to isolate certain aspects of the agency review process as additional services.

Step 3: Define Individual Functions and Duties

In this step, you clearly delineate the functions and duties of each person involved with the project, and estimate the percentage of time it will take each person to fulfill his or her role.

Again, in a start-up firm, all the functions and duties probably will be performed by a single person, the principal. This will change as the firm grows. People, especially those at higher levels, will do more than one kind of task. A principal might have responsibilities in management and administration, project management or design, marketing or public relations, personnel management, and a host of other areas. A project manager might be responsible for particular projects, monitor project quality assurance/quality control, and coordinate certain staff assignments.

Using the project roles and duties form, shown in Figure 5.7, the principal can list the various responsibilities of each person and the percentage of time needed to complete each task. This will result in an array of each person's productive time, leading to identification of total staffing availability and utilization.

For example, a partner in the firm might spend 30 percent of his or her time marketing, 50 percent with clients and leading the project team as principal-in-charge, 10 percent in firmwide management, and 10 percent in paid time off (holidays, vacations, personal time, etc.). A staff-level project manager might spend 75 percent of his or her time on active project management tasks, 5 percent on marketing assistance, 7 percent on firmwide quality assurance, 3 percent on professional activities, and 10 percent on paid time off (vacation, holiday, sick, and personal time). Then if, for example, it was determined that a new project would require all of the project manager's time, and that project manager already had other projects to monitor, the firm would have to consider alternative solutions, perhaps extending the project schedule, requiring overtime effort, or temporarily extending the principal's responsibilities.

Title:	Time Allocation
Function:	%
Duties:	%
	%
	%
	%
	100%

Title:	Time Allocation
Function:	%
Duties:	%
	%
	%
	%
	100%

Title:	Time Allocation
Function:	%
Duties:	%
	%
	%
	%
	100%

Figure 5.7 Project Roles and Duties.

Step 4: Assign Decision-Making Responsibility

In start-up firms with no employees, it is clear who will make all decisions: the principal. But as soon as more than one person is involved on a project, unless it is absolutely clear who will make the decisions, and how, chances are they will be made ad hoc, or according to status rather than responsibility, or by default, or perhaps not at all. Also, depending on who is assigned to the project, the system and structure established by the firm will necessarily be tested, because no two people will act precisely the same way in the same situation; each will perform pursuant to particular individual experiences and personalities. Therefore, a rigid, unalterable system that is uniformly applied is doomed to failure, as no two people will meet the requirements of the system in the same way. It is far better to be flexible and allow for modification and manipulation of the system, to reflect the individual capabilities of the people responsible for implementing it.

One way to achieve this flexibility is to allow key project people to negotiate essential responsibilities among themselves. The benefits of doing so are twofold: all responsibilities will be accounted for, and individual responsibilities will be more clearly defined, more readily accepted, and more likely to be performed well. For example, assume the project manager is unusually adept at keeping on top of collections, even though it is the firm's usual policy to assign that responsibility to the principal-in-charge. If the project manager and principal-in-charge can negotiate the responsibility for collections on the project at hand, the firm may benefit by more timely collections and by having the task performed at a lower level, thereby freeing the principal-in-charge for more level-appropriate work.

A relatively simple way to negotiate responsibilities in this way is to use a responsibility form like the one shown in Figure 5.8. You can use this form to identify, for example:

- Primary responsibility
- Secondary responsibility
- Contribution or participation

A more sophisticated and precise way would be to identify four different levels of responsibility:

Level 1: Deciding or acting ("primary responsibility").
Level 2: Consulting (before the decision is made).
Level 3: Approving (after the decision is made, but before it is implemented).
Level 4: Being informed.

The effective result is a project-specific decision-making process based on the firm's own goals, history, procedures, and personnel; project delivery unit organization and structure; project schedule and deliverables; personnel roles, responsibilities, and time allocations; and individual and collective accountability for decisions.

The process (and its forms) described here encourages individual project planning based on individual project needs. There is no need to replicate specifics from project to project. Rather, once the firm has established its overall goals and project objectives, and has selected a project structure based on these goals, projects can be planned and then monitored according to their unique characteristics and those of the firm.

1. Decide/act *2. Consult* *3. Approve* *4. Inform*	**Responsibility**				
	PIC	**PM**	**PD**	**PA**	**Other**
Determine fee					
Negotiate contract					
Select consultants					
Identify project staff					
Determine client needs					
Prepare program					
Conceptual design					
Schematic design					
Design documentation					
Make technical decisions					
Document format					
Complete specifications					
Track construction changes					
Monitor team progress					
Prepare invoices					
Collect receivables					
Other					

Figure 5.8 Project Responsibility Chart.

Legal and Ethical Issues

6

An architect must be legally qualified to practice. All states and the District of Columbia require individuals to be licensed (registered) before they may call themselves architects or contract to perform architectural services. In short, you are not legally considered an architect unless and until you have been licensed by the state(s) in which you seek to practice. And in some states, architects are required to apply for licenses (but not necessarily to have been licensed) even before they attempt to solicit work.

The purpose of this chapter is to introduce you to the legal and ethical issues involved with becoming a practicing architect.

Registration and Certification

Licensure requirements in all states include the following:

- A professional degree in architecture
- A period of practical training or internship
- Passage of all sections of the Architectural Registration Examination (ARE)

And as to the first requirement, note that in many states, the professional degree in architecture must be from a school of architecture whose program is accredited by the National Architectural Accrediting Board (NAAB). That said, be aware that state architectural registration boards set their own standards, so graduation from a non-NAAB-accredited program may meet the education requirement for licensure in some states.

Each state and each U.S. territory has a governmental authority that registers and regulates architects. Typically, the authority is vested in a State Board of Architecture composed of architects and laypersons appointed to the board by the governor of the state. Without registration issued by the state, no one may engage in the practice of architecture nor use the title "architect" within that state. In addition to issuing registrations, the state boards watch over the practice of architecture within their state boundaries and discipline architects whose practice does not meet minimum standards of professional conduct established by the board.

In 1920, the state boards created a national system for identifying qualified architects, called the National Council of Architectural Registration Boards (NCARB). NCARB is not a governmental agency; it is a federation of all the state boards that register and govern the practice of architecture. Its only members are those state registration boards.

The state boards formulate the rules and policies of NCARB and elect NCARB's officers and directors. Working with the state boards, NCARB establishes national standards for certifying qualified architects. Those standards have been recognized by every state board as adequately rigorous to allow the

state board to register the NCARB certificate holder, generally without further examination or other demonstration of qualifications. Once identified and certified as qualified by NCARB, architects are readily granted registration in almost all United States jurisdictions.

Every state board uses the NCARB ARE as its written examination to test the skills, knowledge, and abilities of applicants for registration, and all state boards require a training (internship) period before candidates may sit for the ARE and become licensed. A few states, such as California, have additional requirements. Many states have adopted the training standards from the Intern Development Program (IDP), which is administered by NCARB. NCARB, of course, similarly requires its candidates for certification to have passed the ARE after completion of an internship program. Like most state boards, NCARB requires a degree accredited by the National Architectural Accrediting Board in the study of architecture.

In addition to setting standards for national certification, NCARB recommends to the state boards rules of conduct, which a majority of state boards have adopted as their own and which serve as a basis for disciplining architects. In addition, several state boards have made continuing professional development a requirement for registration renewal, and it is likely that most other states will follow suit in the future.

Therefore, because you must be licensed (registered) by the state board to practice in any one state, the easiest way to obtain licensure in more than one state is to become certified by NCARB. Furthermore, before starting in practice, it's a good idea to heed the advice given in the "Guiding Principles" box on the next page.

Guiding Principles

- Seek professional advice. Then take it seriously. Your advisors should include: accountants, attorneys, business advisors, public relations advisers, bankers, insurance providers, and other experienced individuals.
- Put everything in writing: contracts, meeting records, confirming notes.
- Keep complete records and set up a good filing system.
- Make use of the published standard forms and contracts, then adapt them to fit the specific scope of the work, business arrangement, and other key parameters. No two projects are identical.
- Protect your image as an ethical professional. Remember you will meet, and need help from, many people during the course of your career.

Starting Up

The legal requirements of starting up depend on the organizational structure you choose:

- *Proprietorship:* Typically, there is no specific legal obligation for starting in a practice as a proprietorship; you just start.
- *Partnership, corporation, or limited liability company or partnership*: You must file the appropriate organizational documents with the state (and sometimes local) authorities. For a partnership, you typically file a partnership agreement; for a corporation, a certificate of incorporation and/or articles of incorporation and bylaws; for a limited liability company, a certificate of formation.

Going forward, owners are responsible for filing their own personal tax returns and paying the appropriate personal income taxes, FICA tax, and workers' compensation tax or insurance. If the company has

employees, the employer is required to withhold employees' income and FICA taxes and file quarterly tax returns with payment of the employer's portion and amounts withheld from employees.

Owners are also legally obligated to notify the appropriate authorities of any change in the ownership or location of the business.

Professional Liability

Because of the special education and knowledge deemed essential for the proper practice of the profession, the laws that established registration for architecture (and other "learned professions," including engineering, landscape architecture, medicine, dentistry, law, and accounting) effectively gave duly licensed practitioners of these professions a monopoly to practice, denying that right to all those who are not similarly qualified and licensed.

It is understood that, in the practice of their profession, architects do not offer standardized solutions or products; rather, they are expected to exercise discretion and judgment as to their clients' interests, based on their education and experience, in a wide variety of nonstandard situations and conditions for which there is never a single "correct" solution. And because under such circumstances, perfection is impossible to achieve, design professionals are not required to be perfect. They are, however, required to perform in a manner consistent with that of other competent professionals practicing in the same jurisdiction under similar circumstances. Anything less may constitute *negligence,* for which the professional can be held personally liable and be penalized.

The test by which design professionals are judged in the event of an error or omission is a comparison against the standard of care that would have been provided by other competent professionals practicing in the same jurisdiction. Negligence is a legal determination that, unless the professional agrees that he or she has been negligent, must be determined in a legal process—a court of competent jurisdiction or previously agreed arbitration. In most cases, the determination of negligence is addressed as a civil matter; penalties, if any, are financial. In a few rare but significant cases, however, malpractice was found to have been so severe as to call into question the professional's ability to continue to practice. In one such case, involving the collapse of suspended walkways in the lobby of the Hyatt Hotel in Kansas City, which resulted in property damage, injury, and loss of life, the structural engineer was found to be negligent and lost his license to practice, first in the state where the incident occurred and then, by extension, in other states in which he had been licensed.

Liability Insurance

Because design professionals can be held personally liable for their own negligence (errors and omissions), they should purchase liability insurance. Several major insurance carriers offer professional liability insurance to design professionals. Such policies include exclusions for certain conditions, deductibles, and per-claim and aggregate limits.

These policies are almost always written on a "claims made" basis, requiring that the insurance be kept "in force," that is, the premiums must continue to be paid to be applicable in the future. The face

value of the policy (e.g., $500,000) is applied as claims are made against the insured in any given year (as long as the policy is maintained in force), until the full amount has been exposed. For example, if three successive claims for damages of $300,000, $200,000, and $100,000 were tendered in a given year against a firm with $500,000 coverage limit, there would be no coverage for the third claim (if damages were awarded in those amounts).

Premiums for such policies are generally written on the basis of annual billings, and depend upon several variables, including the discipline(s) being insured; the types of clients, projects, and services being offered; and the amount of the deductible. Services that historically have not resulted in liability problems, such as planning, are insurable at relatively low rates. Professional liability insurance for professional services on building types that have poor liability histories are generally subject to higher premiums. In recent years, professional liability insurance premiums for architects have ranged from 2 to 3 percent of gross revenues.

In some cases, clients or the design team will buy insurance for a single project. Such "project insurance" is the exception, but can be appropriate for unusual projects or projects needing higher than normal coverage.

Certain activities and relationships can substantially reduce the potential for liability claims and/or the likelihood that such claims will result in the award of damages. These include:

- Prepare sound written agreements.
- Develop good personal relationships with clients and contractors (people are far less likely to sue people they like and respect).

- Maintain clear and regular written communication with clients, consultants, and contractors.
- Address problems proactively when they arise.
- Manage risk in client selection, fee negotiation, and project design and execution.

The last, risk management, comprises five steps:

1. Identify the potential risks.
2. Weigh the possible value of these risks.
3. Avoid the risks that are not worth taking.
4. Reduce the impact of risks that are.
5. Transfer risk to others, when possible, such as your insurance provider.

Legal and Ethical Obligations

As stated throughout this book, most design professionals start their own firms only after they have worked for others. In fact, there is no other way to gain the appropriate experience or meet the normal prerequisites to sit for the architectural registration examination unless one has worked for others. Therefore, design professionals starting a new firm begin with preestablished relationships with their former employers and with the clients for whom they provided services when employed by another firm.

There are at least two kinds of obligations to the firm: legal and ethical. Legal obligations include prohibitions against tortuous interference, against abrogating the general fiduciary responsibilities that owners and certain other high-level employees have to the firm, and contractual responsibilities such as those embedded in partnership or shareholder agreements or in separate confidentiality and/or noncompete agreements.

No one has a right to interfere with another's contractual relationships, including a firm's contract to perform and be paid for client services; anyone interfering with such a contractual relationship, such as by encouraging the client to break a contract, is exposing him- or herself to a potential claim for tortuous interference. If a professional shares ownership with others, then he or she has a fiduciary responsibility to his or her co-owners and the firm not to take any action that would harm the firm in any material sense. Also, if in becoming an owner, or being elevated to a higher status level in the firm, a professional signs an agreement restricting his or her future acts in any legally binding way, then that professional is constrained from doing what he or she had promised not to do. For example, if on becoming an associate in the firm (a title generally signifying increased status, and sometimes signifying additional privileges and responsibilities, as well), a professional signs a noncompete or confidentiality letter, then any act that abrogates the terms and conditions of that agreement exposes him or her to the possibility of legal action. The courts will generally support confidentiality and noncompete agreements that are not unduly restrictive, that is, do not totally restrict the professional from being able to practice his or her profession in the locale where he or she lives and works.

Ethical Responsibilities

The American Institute of Architects (AIA), the oldest and largest professional organization for architects in the United States, with a current membership exceeding 50,000, offers many programs,

services, and benefits. AIA has developed and promulgated a Code of Ethics and Professional Conduct, last updated in 1997. The code is arranged in three tiers: Canons, Ethical Standards, and Rules of Conduct. *Canons* are broad principles of conduct that cover general obligations, and obligations to the public, the client, the profession, and to colleagues. *Ethical standards* set more specific goals, to which (AIA) members should aspire in professional performance and behavior. *Rules of professional conduct* are mandatory, meaning that violation of a rule is grounds for disciplinary action by the Institute.

The Code of Ethics includes 24 rules, some of which incorporate language that generally reflects legal obligations. For example, Rule 1.101 under General Obligations states: "In practicing architecture, Members [of AIA] shall demonstrate a consistent pattern of reasonable care and competence, and shall apply the technical knowledge and skill which is ordinarily applied by architects of good standing practicing in the same locality." Similarly, Rule 2.102, under Obligations to the Public, states, "Members shall neither offer nor make any payment or gift to a public official with the intent of influencing the official's judgment in connection with an existing or prospective project in which the Members are interested." Rule 3.103, under Obligations to the Client, states, "Members shall not materially alter the scope or objectives of a project without the client's consent."

The ethical rules that may affect professionals starting in practice are those that address obligations to colleagues. There are three such rules, and they describe situations that frequently occur, usually without incident or contention.

- Rule 5.201 states, "Members shall recognize and respect the professional contributions of their employees, employers, professional colleagues, and business associates."
- Rule 5.202 states, "Members leaving a firm shall not, without the permission of their employer or partner, take designs, drawings, data, reports, notes, or other materials relating to the firm's work, whether or not performed by a Member."
- And, correspondingly, Rule 5.203, states, "A Member shall not unreasonably withhold permission from a departing employee or partner to take copies of designs, drawings, data, reports, notes or other materials relating to work performed by the employee or partner that are not confidential."

It is reasonable and understandable that professionals starting new firms will want to use examples of work they performed while employees of others, to demonstrate their capabilities as professionals. To that end, Rule 5.203 informs employers of their obligation to permit this. Rule 5.202 informs former employees of their obligation to seek their employers' permission; and Rule 5.201 informs them of their obligation to take and give appropriate credit.

In sum, a professional is obliged to act ethically. For most professionals, this behavior will be easy and natural. For those who need guidance, the AIA's Code of Ethics & Professional Conduct describes what such ethical behavior "looks like."

As already explained, a professional's ethical responsibility may go beyond the legal. If, for example, the owner of a start-up firm acts legally, scrupulously respects his or her employer's relationship

with the client, and does not seek to damage his or her employer's relationship with the client in any way, he or she might still discover ethical obligations he or she must meet.

Assume, for example, that a client's project has come, or is about to come, to the end of a designated phase, and that the client learns that a key employee on the project will be leaving at the point to start a new firm. In such a circumstance, the client is typically free to sever his or her relationship with the architect who started the project and commission the new firm on mutually agreed terms, as long as the client has not been induced to do so. Regardless of who initiated the possible shift of the project, if the departing architect accepts the project, he or she would be well advised to ensure that he or she will not suffer any damaging contractual or financial consequences.

And when information is published about a project, each party is ethically obligated to give appropriate credit to others who have contributed materially to the project, and to not take inappropriate credit for any work for which he or she has not been directly responsible.

The box titled "Ethical Questions" raises a number of dilemmas you should be prepared to face during your career.

The box lists just some of the many situations that can arise. Where the law or the terms of a contractual relationship are clear, the right decision should be obvious; moreover, most architects have an innate sense of what is appropriate ethical behavior and what is not. Many situations, however, are not clear-cut. In these situations, it is usually very important to avoid burning bridges or making enemies. Most

NOTE

The AIA's Code of Ethics & Professional Conduct is not concerned with, and does not address, reasonable and normal business activities. In fact, the antitrust laws of the United States and most states require that architects maintain a free and competitive business environment. As a result, matters of marketing and pricing are deemed to be business, not ethical, matters, and therefore are not directly addressed in the code.

Typical Ethical Questions

- One or more clients you are handling on behalf of your current employer offer to follow you with their current projects if you go on your own. Do you act on this opportunity?
- A potential project comes to you while you are working for someone else. Do you keep it to yourself and develop it or tell your employer?
- You have decided to leave your employer while in the middle of several important projects. How much notice do you give?
- You are pursuing a potential project with another firm that gave you the lead. The client tells you that you can have the project without the other firm. Do you accept?
- A client offers to pay you in cash and not report it. Do you accept? (*Hint:* Your failure to report income is tax evasion.)
- An employee asks to be paid as a consultant rather than an employee with the standard payroll deductions. Your accountant advises that the person does not qualify, but that this issue is unlikely to be caught. Do you agree to the request?
- You are preparing a proposal and you include projects that you did while employed by another firm. Do you credit your former employer in the proposal?
- Some of your projects are being included in a book or exhibit, including projects you did while employed by another firm. How do you credit that firm?
- A client asks you to take over a project currently being done by another firm. The other firm has not been told yet that they are to be replaced. What are your obligations to the other firm?
- An employee of a potential client offers to help you get a project in return for a finder's fee. Should you agree to pay it?
- Your workload drops off and you cannot afford to keep some or all of your employees. How much notice should you give them? Should you pay severance? Help them find other work?
- A client pays you only 75 percent of your fee and refuses to pay the rest, citing dissatisfaction with you and your consultants' work. What do you owe your consultants?
- To be considered for certain public projects, you are expected to contribute to the fund-raising efforts of some elected officials. Do you make these contributions? (*Hint:* Refer to Rule 2.102 of the Code of Ethics & Professional Conduct described earlier.)
- An employee brings his or her own computer loaded with unlicensed software. Do you ignore this?
- You are offered the opportunity to participate in a profitable real estate investment by one of your firm's clients. What do you owe your partners, if anything?

young professionals are unaware of how often professional paths cross. Consultants, former employees, and others you deal with may be in a position later to return the favor, so it's best to treat everyone fairly and equitably.

Here are a few situations that require special attention:

- *Moonlighting.* As stated throughout this book, architects start by working for others, because the only way to become qualified to take the registration examination is to fulfill an internship requirement. Those who choose to start their own practices usually continue working full-time for someone else while building skills, forming relationships, and making contacts that will enable them to go out on their own. When opportunities to practice in their own name come along, they find a way to serve their private clients while remaining employed. In short, they moonlight. If you decide to do this, here are a few pointers: use your own identity, time and resources, not the firm's; don't imply that you represent your employer for your own work; continue to work conscientiously for your employer, to the full extent of your capabilities.
- *Removing documents*. Always ask permission; your employer is ethically obliged to provide copies of documents on which you worked. Volunteer to pay for them; it is your obligation, though your employer may be generous.
- *Taking and giving credit.* Take credit only for what you have done. Be sure to cite your employer on every project on which you participated as an employee.

- *Taking clients*. If you signed a noncompete agreement, with your employer, simply put, you probably can't take a client with you when you leave. If you don't have such an agreement, you are still proscribed from interfering with your employer's contract, but you are free to inform clients for whom you have worked that you are beginning your own practice. The clients may give you work in the future and may even opt to engage you on the project on which you have been employed. Again, don't burn bridges, ever.
- *Soliciting employees, from your firm or another*. As with clients, only a noncompete agreement to which you are a party effectively prevents you from soliciting employees; but keep in mind, reputation is everything, so it is best to inform others of your intention regarding starting in practice. Then let them decide to join you.
- *Cutting fees*. There was a time that fee-cutting was deemed unethical, but since the mid-1970s, it has been viewed as a business matter, not an ethical one. And as a starting practitioner, you will likely have lower operating expenses than established firms and will, therefore, be able to offer lower fees and still be profitable. However, though offering lower fees is legitimate, it is a dangerous tactic because the client, and possibly others, may continue to expect you to charge low fees.
- *Stretching payables.* Stretching payables means failing to pay others, typically consultants, when you have been paid. This is a matter of business, but one that borders on the unethical. You may have a contractual obligation with

either the client or the consultant to pay when you have been paid. Can you get away with not paying for short periods of time? Probably. Should you? Probably not. In addition to expecting your consultants to be responsive to you—which failing to pay them in a timely manner will preclude—you don't want to dig a financial hole that will be difficult to get out of. Also, never, ever fail to pay the Internal Revenue Services for taxes due, not withheld employee taxes or your own.

- *Seeking free goods or services.* This is not only unethical, but is illegal in some cases. Although you are unlikely to go to jail for accepting a sample, even a large sample, from a contractor, vendor, or supplier, you do not want to feel, or be, obligated or beholden to that supplier; and by accepting a "freebie," you will be. Keep in mind how difficult it may be in others' eyes to draw the line between gift, payoff, bribe, and extortion.
- *Asking employees to work for free*. Pure and simple, this is unethical, not to mention illegal.

Contracts

The architect starting in practice will likely encounter three kinds of contracts:

- *Project-related contracts*, especially including the owner-architect agreement, the architect-consultant agreement, and the owner-contractor construction contract.
- *Internal contracts*, especially including ownership agreements for partnerships, corporations, or limited liability companies.

- *Ordinary business agreements*, especially including lease or lease/purchase agreements for facilities or equipment, and loan documents.

By law, a contract is defined as an agreement between two parties to provide goods or services for a consideration, generally money. In essence, an owner/architect agreement records that the architect will provide certain design, documentation, and construction administration services for the owner for an agreed-upon fee. A lease records a lessor's agreement to provide space or equipment to a lessee in exchange for a monthly lease payment.

Although oral contracts are permissible and binding (although in a dispute, it's often difficult to prove that such a contract existed), a written contract is always recommended because you have a piece of paper to prove a contract exists, in the case of a dispute.

In general, an architect starting a firm would be well advised to consult the standard contracts and agreements published by his or her professional organization before assuming any contractual responsibilities, and in particular before accepting contracts offered by others that might include language favoring the presenter.

As with every other aspect of practice, it is hard for any individual to deal with all the legal and ethical issues that arise without some outside advice. Some of these outside sources and resources are discussed in the next chapter.

NOTE

The American Institute of Architects, the American Consulting Engineers Council, the American Society of Landscape Architects, the American Institute of Graphic Artists, and other professional organizations have developed model agreements for virtually all project situations, which are available at modest cost. These model agreements are updated regularly and are generally considered to be fair to all parties.

7 Resources and Support

Though it is possible to go out on your own without any professional assistance at all—essentially, winging it—a wiser move is to launch your firm only *after* you have gathered and coordinated a core group of professional advisors and other resources—organizations and associations—on which you can rely for necessary information, advice, and support. Winging it certainly may seem more gratifying—but only if you're successful—and in the long run, it is far better to have backup support in the wings, to answer a question, suggest a direction, or offer advice that will help you avoid potentially dangerous mistakes and move forward in the best way.

Legal Advice

If you decide to organize your firm as a proprietorship or partnership, it may be possible, as explained in Chapter 5, do so without filing legal documents of any kind, although putting it in writing, in an agreement, is advisable. After you launch, however, inevitably situations will arise that will make it necessary

to have a relationship with an attorney on whom you can rely and with whom you are comfortable speaking. Typical situations for which you would need to seek legal advice include contractual matters, such as those that arise during client agreement negotiations; liability matters arising out of potential or alleged professional negligence; space and equipment lease issues; employment and labor law issues; and insurance and tax matters. Frequently, a five-minute telephone conversation with a knowledgeable attorney can give you exactly the right information that will save you hours of misdirected effort or needless concern.

In Chapter 6, we briefly mentioned that a number of professional organizations for architects, engineers, landscape architects, planners, and graphic designers have developed standard documents for use by their members (and nonmembers, as well). Although relatively straightforward, time-tested, and widely accepted, these agreements do include conditions and language that may be difficult to understand by the uninitiated or uninformed user.

For example, an architect intending to invoke standard contract forms may not know that AIA Document B-141, Standard Form of Agreement between Owner and Architect, is meant to be used in conjunction with AIA Document A201, General Conditions of the Contract for Construction, which it incorporates by reference, and can be used with architect-consultant agreements, as well. Attorneys familiar with professional practice, however, will be well-versed not only in general contractual matters, but with these and other standard documents, as well.

Although it is not likely that professionals starting new firms will be confronted by liability problems

immediately, accidents do happen, relationships go sour, and we live in a litigious society. Attorneys who are experienced in dealing with construction-related problems can be of immense value when such matters arise. Explaining to you how to proceed in a manner that will protect your interests can be a most valuable piece of information.

And if you decide to set up your practice outside the home, then purchasing—or more likely leasing—an office will be one of the first, and most significant, financial decisions you will have to make. Real estate leases are special forms of contract that are frequently developed by real estate agents and brokers for simple or small transactions. However, for larger and more complicated transactions, you would be well advised to seek the counsel of a qualified attorney experienced in real estate transactions. He or she can review and suggest appropriate revisions to pro forma lease documents, as well as negotiate on your behalf.

Finally, because many start-up firms are launched by the initiating proprietor or partners, without other employees, initially, employee and tax issues are likely to be minimal or nonexistent. But as firms grow and add employees, a whole new set of conditions enters the picture, generally involving labor and tax laws. Problems in these areas are generally infrequent and are not likely to exist at all when firms are small, but with growth, problems are more likely to arise.

For example, the notion of how to pay employees—whether on an hourly or salaried basis—is a matter prescribed by the Fair Labor Standards Act and administered by the United States Department of Labor. The act states that employees subject to the

terms of the act must be paid time and a half for hours in excess of 40 hours per week, excluding those employees who are "exempt." Exempt are those employees with professional, managerial, and supervisory responsibilities. Sounds simple enough, but note that the definition of "professional" used in the act is different from the common understanding, leading to unknowing breaches in the law that can result in severe penalties for a new firm. Similarly, dismissed employees who feel that they have been wrongfully terminated or denied appropriate compensation may cause legal problems for a new firm. Again, such a situation is unlikely to affect the start-up practitioner, nevertheless, it is useful to have someone at the other end of the telephone to talk to, just in case.

Accounting Assistance

It is not uncommon for design professionals to begin practice without accounting help. And, if the firm stays very small and operates as a proprietorship, it may never need accounting assistance, since the net income of the firm becomes the proprietor's personal income for which he or she files a personal income tax return. If, however, the firm is initiated as a partnership, subchapter S-corporation, or other more complicated form of organization, then more record-keeping will be required and more complicated tax returns will have to be prepared, both of which typically require the services of an accountant.

It's also a good idea to hire an accountant for an important piece of front-end advice: how to organize the firm's chart of accounts. In even the simplest accounting configurations, income and expense items are charged to different categories (accounts)

with different names, and usually numbers, as well. A firm with the very simplest chart might have as few as three income statement accounts—revenue, expenses, and profit/loss—in which all revenue items would get charged to revenue, all expenses to expenses, and the arithmetic difference would be recorded as profit or loss. This firm might similarly maintain only three balance sheet accounts—assets, liabilities, and net worth.

More useful, even in the early days, is to set up a somewhat more sophisticated chart of accounts, so that income and expense items can be recorded in categories that provide the owner with valuable information regarding his or her business. For example, a start-up firm would be well advised to set up a chart of accounts with several revenue accounts (fees, reimbursables, consultants, and miscellaneous revenue) and several direct and indirect expense accounts (labor, consultants, reproductions, travel, occupancy, insurance, benefits, taxes, and other general and administrative expenses, at a minimum). Then, as the firm grows, the chart can be expanded, from which reports can be generated that produce the financial information that allows the owner(s) to better understand and manage the operations of the firm.

Banking

Bankers are important members of the community, especially in small communities. In addition to developing broad understanding of money and real estate markets, they serve a wide variety of individuals, companies, institutions, even governmental agencies, and consequently can develop a keen knowledge of the arenas in which they operate. A

helpful banker willing to share this knowledge and the related contacts can be very useful for design professionals.

It hardly need be said that there is no practical way to operate a firm without a bank account. From the very first day it is open for business, the firm will deposit receipts and make disbursements through a checking account. As the firm grows, the bank may become the depository for withheld and employer taxes, as well. At the same time, it's wise to establish a personal relationship with a banker. If in the future, the owner chooses to expand the firm's facilities, add staff, purchase equipment, or otherwise grow the firm without contributing personal funds, it will be necessary to secure a loan, and this will be easier to do if you have made yourself and your firm known to a banker. And help securing a loan is only one of the many services a bank can provide a growing design firm. Banks can, for example, also help obtain a letter of credit, required by an office lease, or make cost-effective lease terms for computer hardware and software. In sum, get to know your banker and keep him or her informed of the firm's progress and success.

Management Consultants

Within the last generation, management consulting for design professionals has become identified as a discipline unto itself. Comprising primarily individuals who leave architecture or engineering firms to set up individual consulting practices based on their personal knowledge, experience, and skills, a few management consulting firms are in their second or third generation of ownership. Some management consultants develop singular capabilities, such as marketing or financial management, that they then

offer to the marketplace. A few firms, like The Coxe Group, Inc., have developed larger, multidiscipline practices that offer a wide range of services including marketing and financial management, key personnel search, ownership transition, project partnering, strategic planning, and assistance with mergers and acquisitions.

Consultants of many kinds can provide information, expertise, perspective, and impartiality to design professionals. Because they are hired to help address management issues for a wide variety of client types, they have the opportunity to experience situations of all kinds. The best consultants assimilate what they learn from these situations, understand the underlying issues and principles, and apply their knowledge to address each new problem they face. In addition, as consultants, they can be more impartial, which is a big advantage for their clients as they struggle to reach solutions that are in their best interest.

But a few words of advice are in order before you hire a consultant of any stripe. Find one who:

- Listens well and understands your problem.
- Has the requisite experience and knowledge to minimize the learning curve.
- Suggests an approach that appears to be effective and proportionate to the issue.
- You will feel comfortable working with and can trust.
- Proposes costs that are appropriate to your situation.

Professional Organizations

Each of the design professions has an organization that represents its members' interests in the profes-

sion, with related professions and industry, in the marketplace, and in government. These groups provide a vehicle for professional exchange; develop standard instruments, documents, and practice aids; recognize contributions of significance (e.g., give awards for excellence in design and practice); and generally set the standards for the profession it represents. These organizations include:

- American Institute of Architects (AIA) (www.aia.org)
- American Consulting Engineers Council (ACEC) (www.acec.org)
- American Society of Civil Engineers (ASCE) (www.asce.org)
- American Planning Association (APA) (www.apa.org)
- American Society of Landscape Architects (ASLA) (www.asla.org)
- American Society of Interior Designers (ASID) (www.asid.org)
- American Institute of Graphic Artists (AIGA) (www.aiga.org)
- Society of Environmental Graphic Designers (SEGD) (www.segd.org)

The aforementioned professional organizations do not regulate design practice, so membership in them is voluntary (recall from Chapter 6 that the state registration boards take care of licensing design professionals). Nevertheless, start-up professionals are advised to become members in the appropriate organization, then use them as a valuable resource. Most have staff to answer professional questions and provide guidance or to refer you to others who may be better able to help.

As noted repeatedly, these organizations generally produce agreements, contracts, forms, instruments, guides, checklists, and other practice aids; but they may also publish books, tapes, CDs, and electronic newsletters, all of which make it easier for members to stay abreast of new developments in the field and to improve their own practices.

For example, the AIA's publication, *Architect's Handbook of Professional Practice,* now in its thirteenth edition, provides an excellent overview of virtually every element of practice that one might want. And the organization's Standard Form of Agreement between Owner and Architect, and the accompanying document, Standard Conditions of the Contract for Construction, were developed in concert with the Association of General Contractors (AGC), and have become the standard in the industry—widely used and widely respected by most participants in the building process.

Another organization, the American Council of Engineering Companies (ACEC), has instituted a peer review process, which professionals can use to have their firms reviewed by a committee of their professional peers.

Technical organizations, too, are excellent resources for information in their specialties. These include:

- American Society for Testing and Materials (ASTM) (www.astm.org)
- Building Owners and Managers Association (BOMA) (www.boma.org)
- American Institute of Steel Construction (AISC) (www.aisc.org)
- National Concrete Masonry Institute (CMI) (www.ncmi.org)

- Precast Concrete Institute (PCI) (www.pci.org)
- Brick Industry of America (BIA) (www.bia.org)
- General Building Contractors Association (GBCA) (www.gbca.org)

And for information about the market sectors in which design professionals work, or want to work, client organizations are good resources. They include:

- American Hospital Association (AHA) (www.hospitalconnect.com)
- American Association of School Administrators (AASA) (www.aasa.org)
- Society of College and University Planners (SCUP) (www.scup.org)
- American Association of Homes and Services for the Aging (AAHSA) (www.aasha.org)
- International Council of Shopping Centers (ICSC) (www.icsc.org)

Similarly, business, civic, political, and charitable organizations can be excellent resources to learn about the community in which you live and work. Some of the most well known are the Better Business Bureau, Chamber of Commerce, Republican and Democratic Clubs, Rotary, Lions, Elks, and others.

Former Employers and Colleagues

We've said it many times in this book, but it bears repeating: Don't burn bridges. Former employers and professional colleagues are great sources of information, assistance, inspiration, and sometimes even clients. Design professionals are generally willing to help one another. Not only do they understand that, as a

matter of principle, they have an obligation to train their successors—hence, future competitors—but they are generally disposed to want to help on a personal level. They are usually willing to provide all manner of detailed, often confidential information (salaries, multiples, fees, costs, etc.), as long as it is not being requested in a competitive situation.

Former employers are also excellent sources of advice, and they will sometimes refer prospective clients they cannot or don't want to serve. This is a win-win-win situation: it helps the prospective client by providing a reference to a professional better equipped to serve him or her at that time; it helps the referring professional by providing an effective and face-saving way to turn down an unwanted client; and certainly it helps the professional to whom the prospective client is referred.

Former employers may also agree to, even enjoy, participating in a mentoring relationship with a former subordinate employee, especially when the relationship is the continuation of a mentor-protégée relationship that began in the employer's firm. Imagine having a senior professional available to ask questions of any kind, and who can offer the fruits of his or her long experience in the profession. Although it might be difficult to hire such a person, some professionals will give of themselves, if asked. One recent retiree we know was so pleased to be asked for advice that he joined the new firm on a consulting basis.

Software Programs and Website Sources

Like so many others, in the last decade, the design profession has been revolutionized by computeriza-

tion, to the extent that virtually all design professionals who are starting practices nowadays are well versed in the use of computers for word processing, calculations, design and construction documentation, three-dimensional representation, email, and website research.

You may find the following software programs, which are widely used in the profession, to be very helpful as your firm grows:

- *For word processing:*
  Microsoft Word (www.microsoft.com)
- *For marketing:*
  ACT! (www.act!.com),
  FileMaker Pro (www.filemaker.com)
- *For email:*
  MS Outlook (www.microsoft.com)
- *For project management:*
  MS Project (www.microsoft.com)
- *For financial management:*
  Deltek Advantage (www.deltek.com) and
  Sema4 (www.deltek.com)
- *For spreadsheet applications:*
  Excel (www.microsoft.com)
- *For graphics:*
  Adobe Photoshop for image editing, Adobe InDesign for page layout, and Adobe Illustrator for illustration and 2-D graphic design (www.adobe.com)
- *For image viewing and sorting:*
  ACDSee (www.acdsystems.com)
  Paint Shop Pro (www.jasc.com)
- *For database administration:*
  Microsoft Access (www.microsoft.com)
  FileMakerPro (www.filemaker.com)

And check out the following websites to access professional organization news, general information, programs, and documents quickly and easily:

- American Institute of Architects: www.aia.org
- National Council of Architectural Registration Boards: www.ncarb.org
- American Consulting Engineers Council: www.acec.org
- American Landscape Architecture Association: www.asla.org
- Society of Environmental Graphic Designers: www.segd.org
- American Planning Association: www.planning.org
- American Society of Interior Designers: www.asid.org

And these websites will be useful in accessing books and software, technical, marketing, and other building-related information:

- *For information about AutoCad:* www.autodesk.com
- *For books and software:* www.buildnet.com
- *For books, software, and estimating tools:* www.buildersbookloft.com
- *For books and software:* www.constructionlounge.com
- *For MicroStation CAD product literature and technical assistance:* www.bentleysystems.com
- *For general resource information:* www.deathbyarch.com
- *For professional issue chat rooms:* www.aol.com
- *For GO ARCH, a professional issue chat room:* www.compuserve.com

- *For building materials and products specs, tables, illustrations and drawings:* www.sweets.com
- *For technical standards:* www.ansi.org
- *For market analysis and lead tracking:* www.fwdodge.com
- *For regional construction industry information:* www.thebluebook.com
- *For organization and business directories useful in marketing:* www.galegroup.com

Although no one starts fully formed, there is a wealth of fellow professionals, consultants, professional organizations, and vendors who are ready, willing, able, and usually eager, to help.

Strategic and Business Plans

8

A central theme of this book is the recommendation to build your firm within the framework of a plan. Though this plan may be as simple as making a list of goals, itemizing a budget, and conducting research on potential clients, almost always it is worth the extra effort to take a more comprehensive planning approach, one that establishes an integrated plan for all aspects of the practice.

There is no standard format to follow for devising a comprehensive plan, but many experienced firms find it advantageous to develop both strategic and business plans. Most also institute a process for updating their plans (usually annually), and then commit the plan to writing. Both the process and the written plan are important.

The process is important because it provides a way to think about, refine, and document the various elements of the future practice. The plan derived from the process documents the results of the planning and serves as a checklist for measuring the progress toward achieving the stated goals. In this chapter, we'll delve into the benefits of both strategic

and business planning. First, however, familiarize yourself with the 10 guiding principles given in "The Practice Plan" on page 167.

Strategic Planning

A strategic plan in this context is defined as a clear and coherent *vision* for the future as seen by the firm's stakeholder(s), and an *action plan* for implementing the vision, with clearly identified tasks, responsibilities, priorities, and milestones.

When you begin to consider your vision for the future—a vital step in the planning process—recognize that some front-end "blue-sky" thinking is acceptable, and may even be energizing; but it is important to keep in mind that your vision should identify a future that is reasonable, achievable, and, to the greatest degree possible, measurable, so that the stakeholders can ensure that they are making progress toward realizing their goals.

Strategic Planning Process

Here we look at two strategic planning models—one longer and more complex than the other—both of which provide a useful framework for incorporating frequently used planning terms and issues. First we'll look at the long-form model, which is a nine-step process.

1. *Values*. Establish the underlying, philosophical concepts on which you intend to build your future, that lead to a . . .
2. *Mission*. Make this an inspiring, but general, description of what you want to be, leading to definition of a . . .
3. *Vision*. Articulate your overall goals, the description of which should include major

The Practice Plan

1. *Follow the leaders*. Most successful firms plan their future. At a minimum, your plan should include: a vision statement and summary of goals, a marketing plan, a financial plan, an operations (including technology) plan, and a human resources plan.
2. *Set realistic goals*. Have an intermediate and a long-term vision of where you want to go.
3. *Know yourself*. This means know your strengths and weaknesses. Perform a strengths, weaknesses, opportunities, and threats (SWOT) analysis (defined later in the chapter).
4. *Build a firm with the required skills*. Plan to build or acquire the capabilities to accomplish your goals.
5. *Focus on ways to get work, build momentum, and establish the desired image*. A realistic marketing plan is a central feature of any plan.
6. *Create a financial foundation*. This will enable you to support the practice and build reserves.
7. *Accept change*. Change occurs whether we like it or not, so be prepared for inevitable changes that will take place in personnel, organizational structure, the marketing and financial climates, and others.
8. *Plan for excellence*. Excellence is not achieved by talent alone. Plan for it.
9. *Never be satisfied*. No successful firm rests on its laurels.
10. *Be flexible*. This means be ready and willing to take advantage when opportunity knocks. As Yogi Berra once said, "When you reach a fork in the road, take it."

areas of emphasis to move you toward your mission, leading to identification of . . .

4. *Obstacles*. Identify anything or anyone that stands in the way of you fulfilling your mission, leading to identification of . . .
5. *Areas of focus*. Know where you have to focus to overcome the obstacles, leading to definition of . . .
6. *Goals*. Do this for each focal area listed in step 5, leading to the shaping of . . .

7. *Strategies*. Decide on the approaches you will take to achieve your goals, leading to the development of . . .
8. *Action plans*. Specify how you intend to implement the strategies, and will lead to the . . .
9. *Business plan*. Annualize, budget, follow up, and keep implementation on track.

For a start-up firm, however, this long process is probably more layered than is really necessary to develop a strategic plan. When the founders have an intuitive understanding of their own values, which they undoubtedly do, then they can use the relatively simple, three-step process:

1. Perform a SWOT analysis.
2. Formulate a vision.
3. Do action planning.

We'll explore each of these steps more fully, using case studies of our fictional firm, Able & Baker Architects.

SWOT Analysis

SWOT is an acronym for strengths, weaknesses, opportunities, and threats. In a SWOT analysis, founders start by identifying what they understand to be their strengths, weaknesses, opportunities (in the marketplace), and threats against potential success. This will provide information, in a general way, to help complete the more specific visioning process in step 2.

Visioning

In this step, founders reflect on, and then document, their vision of what they intend the firm to be at a fixed future time, usually between three and five

CASE STUDY

Able & Baker Architects SWOT Analysis

As the partners in Able & Baker Architects approached the end of their third year of practice, they decided to develop a strategic plan for the next three years. At an evening meeting, they performed an informal SWOT analysis and identified the following:

- *Strengths*: design ability, client service, growing reputation as experts in healthcare facilities
- *Weaknesses*: staff quality and quantity, inefficient principal-to-staff ratio, inconsistent quality assurance procedure (although no serious liability problems)
- *Opportunities*: large and diverse healthcare marketplace, large and diverse employee pool
- *Threats*: other capable healthcare firms in the market

years out. (Less than three years rarely provides sufficient time for substantive change and achievement, and more than five is usually too far out, considering the substantive change, either internally or externally, that could occur in that time frame.) For the point in time chosen, at a minimum, the firm's founders should consider the firm's:

- Location
- Capabilities
- Services offered to the marketplace
- Design philosophy
- Size, in numbers of people
- Volume of fees (to be) sold, in net revenues
- Profit to be earned
- Markets, expressed geographically and by client type
- Human resources (the nature and quality of staff)
- Technology (nature and quality)

- Reputation in the marketplace, in the eyes of both clients and prospective employees
- Culture (what it "looks and feels like" inside the firm)
- Ownership (who will own the firm)

In addition, the founder(s) should document how they define:

- Their roles
- Their base salaries
- The time they expect to expend in the interest of the firm

By thinking about and documenting these key elements, founders will have identified virtually every important aspect of the firm they're planning.

CASE STUDY

Able & Baker Architects Visioning Process

During the week following their SWOT analysis, the partners thought about and documented their personal visions for the firm at the end of the next three-year period. The following Saturday they met to discuss their respective visions. At that meeting, both partners presented their personal vision, which revealed both a great deal of congruence, but also incongruence regarding the firm's size and markets. Able expressed a desire to grow at an aggressive rate of 20 percent per year, compounded, while Baker wanted to grow at a more modest rate.

Moreover, Able also articulated a desire to expand the firm's markets into medical office buildings and nursing homes, which he saw as connected to the firm's essential expertise while creating some diversity; Baker wanted to continue to focus on the firm's core strengths. After discussing the issues, Able agreed to modify his vision to reflect a more modest growth rate of 15 percent, and to treat medical office buildings and nursing homes as "targets of opportunity," rather than seek that work proactively.

CASE STUDY

Able & Baker Architects Three-Year Vision (2005)

- *Location:* New space in the same city
- *Size:* Staff of six
- *Volume:* Net revenue, $500,000
- *Profit:* Fifteen percent of net revenue
- *Capabilities:* Comprehensive architectural services
- *Markets:* Healthcare institutions within a one-and-a-half-hour radius
- *Human resources:* Well-educated, well-trained, client-centered staff
- *Technology:* Fully integrated at an appropriate level for the practice
- *Reputation*: Expert in our field; firm of choice in our market; professional and caring place to work
- *Culture:* Professional, ethical, hard-working, focused on project success
- *Ownership:* Same as current

They will have, in a manner of speaking, painted a picture of their firm in a way that enables them to begin to identify specific steps to take to realize that vision.

Action Planning

With a clear vision for the future clearly drawn, the founders are ready to begin action planning. Appropriately, the visioning process is the responsibility of the stakeholders, as only those who are, or will be, at risk have the right to determine the firm's future. Metaphorically, they decide where their train is going. In contrast, the action planning process is more successful when a broader group of people participate. Employees, advisors, colleagues, and others

who "are on the train" but who do not set its direction, can, nevertheless, make a significant contribution to the quality of the action planning.

A proven successful technique for participants to use in the action planning process is to time travel; that is, to imagine themselves in the future, celebrating the successful achievement of their vision at the end of the defined planning period. After visualizing a successful outcome, it is easier to identify the things they *would have done*, individually and collectively, to be successful. This visualization process frees the action planning participants from the constraints and limitations of the present, and allows them to think more freely and expansively about the future.

To that end, each of the participants in the action planning process (guided by a facilitator, if possible) makes a list of actions that they imagine would have been done to realize the vision established by the stakeholders. They then share their lists with each other and discuss them. The participants then set relative priorities on each of the items on their list—to identify which items they see as more or less important to achieving the overall vision.

Next, the participants identify the individual or group of individuals they believe to be best equipped to ensure that each identified action is accomplished, along with a reasonable milestone for each.

In the end, the strategic plan should include every important element necessary to success, as determined by the stakeholders, plus an action plan for accomplishing them.

Strategic Planning Summary

When firms are very small, most of the work involved in carrying out the action plan will fall on the princi-

CASE STUDY

Able & Baker Architects Action Planning

Once they had articulated a clear and coherent vision for the next three years, the partners and the new staff member they had hired met to develop an action plan to implement the vision. Working individually, they identified the specific actions that they believed would have to be taken to realize the vision; they then shared their thoughts, documenting suggested actions as they were mentioned. The actions they suggested included:

1. Recruit and hire an experienced healthcare architect.
2. Initiate a firmwide 401K plan.
3. Prepare project sheets to use as promotional pieces.
4. Develop a manual of drawing standards and guidelines.
5. Upgrade the CAD software.
6. Write articles on new developments in healthcare design.
7. Start every new project with a formal kickoff meeting.
8. Become active in the Academy of Healthcare Architects.
9. Schedule "client satisfaction" meetings with all clients.
10. Institute regular staff reviews.
11. Delegate budget and schedule monitoring responsibilities to key project staff members.
12. Develop a specific marketing plan.
13. Write program for new office for the firm when it grows.
14. Create a specific descriptions for every position.
15. Plan firmwide social events.

During the discussion, the participants also determined that for the firm to realize its vision, the most important actions they had to focus on were numbers 1, 7, 11, and 12:

1. Recruit and hire an experienced healthcare architect.
7. Start every project with a formal kickoff meeting.
11. Delegate budget and schedule monitoring responsibilities to key project staff members.
12. Develop a specific marketing plan.

Therefore, they immediately assigned responsibilities and initial milestones for each of those items and agreed to meet quarterly to review progress.

pals. As the firm grows, however, it will be possible for many of the actions to be accomplished by others.

Like all planning activities, strategic planning is dynamic, not static. Regardless of the thoroughness and specificity with which you prepare a strategic plan, a number of factors may cause the plan to change over time—perhaps the people and their goals, the clients and their needs, technology, the macro-economy, or something else. Therefore, you should review your strategic plans periodically, ideally annually or semiannually.

And because strategic plans typically are made to cover several years, keep in mind that the goals explicit in the vision are not intended to be accomplished in a few weeks. Rather, the goals are meant to express longer-range aspirations that require time, energy, and money over the long term. In the meantime, business must continue as usual, meaning that the time, energy, and money required to meet future goals must be expended *in addition* to the resources being used currently. By conducting a semiannual or annual review, you'll be able to easily identify which short-term objectives have been realized, or have failed to be realized. The review will also help guide you as you change the plan to reflect or respond appropriately to any external changes that have occurred during the established time frame.

Business Planning

In contrast to the strategic plan, which identifies goals that can be achieved over relatively long periods of time, generally three to five years, the purpose of a business plan is to integrate the firm's marketing, finance, operations, and human resources in a

shorter time frame, usually on an annual basis. The business plan is the instrument that helps principals to plan, in both a general and detailed way, exactly how they expect to use the firm's resources in the coming year.

Each element in the plan relates to the others. Revenue targets generate marketing goals and the need for appropriate professional/technical staff and overhead support. Staff growth (in numbers of people or expense) creates the need to produce revenues to pay for them, and technical and other indirect expenses, to support them. The desire to step up the marketing effort or to increase any other component of indirect expense adds to the total overhead expense, thereby increasing the overhead rate, thus creating the need for additional revenue.

Clearly, then, business planning is an iterative process. As noted in Chapter 3, there are only three parts to the financial equation: revenue, expense, and profit or loss, and it is possible to start the planning process with any one of those three factors. That said, the conventional approach for firms that have been in business for several years is to begin the planning process with revenues—the fees and other monies it expects to earn the following year. Firms that have a more sophisticated management structure and that have sufficient knowledge of their marketplace usually can reasonably and accurately project the next year's revenue. Less sophisticated firms will simply extrapolate from what they have earned in fees during the current year. In either case, the business planning process starts by identifying next year's revenues. The initiating assumption might be something like this: "We'll do $\$x$ in net revenues this year; next year we can do $x + y$."

With a defined revenue amount as the starting point, planners can next specify the expenses likely to be related to those revenues. To do this they must answer a series of questions:

- What will we have to do to earn those revenues?
- How many people will we need? With what level of experience and ability? At what salaries?
- How much consulting help will we need?
- How much will we have to spend in other direct expenses? How much in nonsalary indirect (overhead) expense?
- What will those revenues and those expenses leave in profit?
- Is that profit sufficient?

If the answer to the last question is no, the planning process is reiterated with different assumptions that will yield the desired profit.

Smaller or newer firms with insufficient historical data on which they can rely may choose to start the planning process from the point of costs, from which they generate income. Their initiating assumption might be: "We have a current payroll of $\$a$ to which we expect we will have to add raises of $\$b$, yielding a new payroll cost of $\$c$. Based on current payroll utilization and our traditional salary multiplier, those labor dollars will generate $\$d$ in net revenues. We also expect that overhead expense will increase by e percent, so our total cost will be $\$f$. Subtracting the total operating cost (f) from revenues (d) yields profit. Again, if profit is sufficient, and an examination of the various line items does not turn up other significant problems, the planning process is over. If, however, profit is insufficient, the plan-

ning process is reiterated using different assumptions.

A very few firms begin the planning process by identifying the amount of profit they wish to earn in the coming year. Then, starting with profit, they identify the overall revenues and expenses that will be required to produce that profit; next, they analyze those amounts to ascertain that they are reasonable, achievable, and consistent with the firm's vision for the future. Again, the process becomes iterative if any element is deemed to be unreasonable or unachievable.

Take a look now at two business plans for Able & Baker Architects, first using the revenue generation method and then the cost projection method.

CASE STUDY

Able & Baker Architects Business Plan Using the Revenue Generation Method

Using as a template the firm's Income and Expense Statement (refer back to Figure 3.5) at the end of the first year of practice, Able and Baker set about developing a business plan for the following year. Confident they will be successful in securing new commissions, they intend to add a professional/technical staff person to enable them to allocate more time for marketing. They start by creating a revenue target based on their goal to increase the firm's net revenues by 25 percent, or $200,000 × 1.25 = $250,000 for the first year.

Assuming that consultants and other direct expenses will grow proportionally, they project $50,000 for consultants and $15,000 for other direct expenses.

They calculate direct salary expenses as a function of their first year's history of achieving a net multiple of 2.8 times salary (though they had hoped to do better). Although they expect their own utilization to drop, they also anticipate that the new employee will be highly utilized.

They expect payroll and benefits expenses to increase in proportion to salaries, to $30,000, while occupancy and general and administrative expenses are expected to increase to $11,000 and $24,000, respectively, bringing indirect expenses to $125,000, a combined 25 percent increase.

The resulting profit planned for the year is $35,000, 14 percent of planned net revenues and 11.1 percent of planned total revenues. Able & Baker Architects' planned income statement using the revenue generation method for the end of the next year is shown in Figure 8.1.

Business Planning Summary

Regardless of the starting point, whether revenue, labor cost, or profit, the result is a business plan that identifies the relationship between productive (utilized) staff salaries and revenue, the revenues that must be produced by those responsible for marketing the firm, the staff required to produce those reve-

Revenues		
Gross Revenues	$ 315,000	
Reimbursable revenue—Consultants	50,000	
Reimbursable revenue—Repro, travel, etc.	15,000	
Net Revenue—Architectural fees	$ 250,000	100.0%
Direct and Reimbursable Expenses		
Direct salary expense	$ 90,000	36.0%
Consultants expense	50,000	20.0%
Repro, travel, etc.	15,000	6.0%
Total direct expenses	$ 155,000	62.0%
Indirect Expenses		
Indirect salary expense	$ 60,000	24.0%
Payroll and benefits expense	30,000	12.0%
Occupancy expense	11,000	4.4%
General and administrative expense	24,000	9.6%
Total indirect expenses	$ 125,000	50.0%
Profit (Loss)	$ 35,000	14.0%

Figure 8.1 Able & Baker Architects' Planned Income Statement, Revenue Generation Method.

nues, and the related overhead expenses (including marketing, of course), that will be required to operate the firm.

The numerical relationship between direct and indirect salary expense is called the *utilization rate*: direct hours or direct salary expense divided by total hours or total salary expense. As explained in Chapter 3, the range within which most profitable firms operate is .60 to .65.

The numerical relationship that describes the amount of indirect (overhead) expense that must be covered by each dollar of direct salary expense is called the *indirect expense* (or *overhead*) ratio: total indirect expense divided by direct salary expense. Although the current norm for established firms approximates 1.50, it will probably be lower for start-

CASE STUDY

Able & Baker Architects Business Plan Using Cost Projection Method

In thinking about the upcoming year, Able and Baker decide to tackle their planning by projecting their anticipated net costs, that is, before consultants and other nonsalary direct expenses. They expect to keep their salary draws at $60,000 each, $120,000 for both, but they plan to reduce their utilization from 60 to 55 percent in order to devote more time to marketing and training. They plan to hire a professional/technical staff person at an annual salary of $30,000, and expect to have that person working 80 percent on projects, adding $24,000 to direct salary expense and $6,000 to indirect salary expense. The combined principal and staff utilization yields $90,000 in direct salary expense and $60,000 in indirect salary expense.

Although they hope to negotiate better fees, they project net revenues at the same 2.8 multiple that they earned in their first year of practice, which yielded $250,000 in net revenues.

The resulting cost-based projection for Able & Baker's second year is shown in Figure 8.2.

	Total	Utilization	Direct Expense	Indirect Expense
Able salary	$ 60,000	.55	$33,000	$27,000
Baker salary	60,000	.55	33,000	27,000
Staff salary	30,000	.80	24,000	6,000
Total salaries	$150,000	.75		
Direct salary expense			$90,000	
Indirect salary expense				$60,000
Net revenue (@ 2.8 × Direct Salary)	$250,000			
Direct salary expense	$ 90,000			
Indirect salary expense	60,000			
Other indirect expense	65,000			
Indirect expenses	$125,000			
Total expenses	$280,000			
Profit	$ 35,000			

Figure 8.2 Able & Baker Architects Cost-Based Projection.

up firms and each firm should establish the level at which it can operate comfortably and be profitable. Most new firms will operate at an overhead ratio of 1.0 or less in their early years.

The numerical relationship between the revenues produced by the firm's staff and the cost of the labor to produce that revenue is called the *net multiple*, or *net earned multiple*: net revenues divided by direct salary expense. Although the current norm is very close to 3.0, each firm should establish the net multiple it is able to charge clients in order to produce good work and make an acceptable profit.

Market and financial planning are, of course, only two of the important parts of the firm's plan for its future. The firm's services should get equal attention. This is the subject of the next chapter.

Planning for Excellence

9

The purpose of the firm's strategic and business plans is twofold: to address financial, marketing, and other business issues, and to facilitate the achievement of excellence, the latter which should be the greatest concern of any successful firm.

While it is true that most significant works of architecture are usually developed under the guidance of a single strong design leader, credit for such works must always be given to the role played by the many other participants in the design process. Typically, more than 10 people (architects, engineers, interior designers, specialist-consultants, construction managers and, of course, clients) are involved in the design decision-making process for most significant projects, and many have 50 or more. Even when Brad's grandfather was starting his practice and sharing office space with Frank Lloyd Wright in the 1890s, this was the case.

As any experienced architect with his or her ego in check will admit, design excellence is, in part, a result of successful management of a complex team, all of whose members contribute to the quality of the

NOTE

Though this chapter discusses the goal of excellence using the example of an architectural design firm, the basic guidelines contained here may be applied to any design firm.

final result. Thus, the ability to select, manage, and train this team of individuals is always critical to a design firm's success. David H. Maister, in his book *Practice What Your Preach* (New York: The Free Press, 2001) listed nine statements he regards as best predictors of financial performance (see the box below).

Don't misunderstand: We are not saying that design excellence can be achieved by management alone, or even that it is the most important factor. Management skill cannot substitute for high-quality design, but it can make those with design ability more effective. Thus, design quality, and helping to achieve it, must be a central management issue in any firm concerned with design excellence. And, as a central issue, it should be addressed in the firm's plans for its future.

At first, it may seem that saying design quality should be a central management issue blurs the traditional boundary between design and management in architectural practice. Certainly, most design pro-

Best Predictors of Financial Performance

- Client satisfaction is a top priority at the firm.
- Firm has no room for those who put their personal agenda ahead of the interests of the clients or the office.
- Those who contribute the most to the overall success of the office are the most highly rewarded.
- Management gets the best work out of everybody in the office.
- You are required, not encouraged, to learn new skills.
- Invest a significant amount of time in things that will pay off in the future.
- People within the office always treat others with respect.
- Quality supervision on client projects is uniformly high.
- Quality of the professionals in the office is as high as can be expected.

fessionals make a careful distinction between management and design; one has to do with finance, administration, and other related matters, while the other is the core of a design practice. We argue that management and design cannot be separated in practices that aspire to achieve consistent quality. Consider these situations that illustrate this point:

- The new firm that is spending so much effort surviving that it cannot focus enough on design. How does it reduce the effort required just to survive?
- The established firm with a solid—but dull—reputation that, more often than not, is losing out on the best jobs and whose staff members are moving to other firms with "hotter" design reputations. How does the firm meet this challenge?
- A firm that is growing rapidly, thanks to the design skills and reputations of the founding principals, who no longer can find the time to design, and so are assigning the work to a constantly changing group of employees, thereby relinquishing consistent quality of design. How do the principals regain control over quality?
- The firm that more frequently is asked to compete on a design basis for jobs, none of which it manages to win. The losses are expensive and demoralizing. Can the firm be restructured to compete more effectively? Should it make the effort to compete at all?
- The firm that has done good work on small projects but that cannot break into larger, more professionally challenging projects. How does the firm obtain the design opportunities it wants and needs to grow?

- The firm that is organized such that design, production, and construction are run by different people, resulting in designs that are often unrecognizable by the time they are built. How can design control be combined with management efficiency?
- The firm that always seems to encounter project problems—whether in budget, schedule, or client dictates—that prevent it from achieving the quality of design it seeks. How can this firm effectively control the process of designing and constructing a building?

As you can see, wherever design is carried out by a team (as is the case in most major projects today), wherever design depends on having and guiding receptive clients (as most good design does), or wherever the process of doing a project has an impact on the result (as most processes do), management is a factor in producing quality design.

If effectively planned and controlled, the interaction between management and design can be a significant help in achieving the highest possible design quality within the inherent constraints of each project.

Achieving Consistent Quality in Design

As stated at the beginning of this chapter, consistent design quality depends primarily on the skill and force of the firm's design leadership (keeping in mind that leadership is a human characteristic and cannot be conferred). But it is also dependent on these other factors as well:

- How the firm defines its goals for design in conjunction with other aspects of its practice.
- The types of project the firm secures.
- How the firm defines the design process, allocates resources to each phase of this process, and monitors this process as the project is executed.
- How the firm is organized.
- How the firm relates to its clients.
- How, in this media-influenced era, the firm builds its design reputation so that it attracts the clients and staff it requires to perpetuate both its image and the substance of design excellence.
- How the firm uses and manages the talent, experience, energy, and will of the entire project team.

Each of these factors affects design quality differently in every firm, so we cannot offer a definitive answer to any of the questions raised, but what is clear is that the search for the right framework is an essential step toward achieving consistent design quality.

Setting Goals

The values and objectives of a firm's principals—no matter how loosely expressed—set that framework. To state that the overriding goal is to provide the client top-quality service that results in building solutions that are esthetically, technically, and functionally advanced, and are of consistently high quality, is not enough. Every goal set by the principals has an impact on how the firm responds to the design quality factors just listed. Firm targets for size, profit-

ability, growth, type of projects, ownership, control, and other areas all have a direct or indirect impact on design quality.

For example, a firm that plans to grow into a 100-person office with a practice targeting the market of hospitals and laboratories will have to pursue design excellence using a different set of constraints than a firm that pursues housing and office projects and that does not want to expand beyond the number of projects that can be personally directed by the firm's founding principals. The former will have to be able to support more than one principal designer, plus a core staff comprised of senior technical specialists who share project leadership; the latter firm, in contrast, will be able to maintain centralized control in the hands of a single design principal.

But what may have the most direct impact on design quality is how the principals define design quality and set goals to achieve it. It is particularly important to avoid the tendency to use only *quantitative values* as the basis for measuring the firm's achievements. When this happens, those primarily involved in design will find the going rough if the firm measures success solely in terms of optimized revenues and minimized expenses. Creativity, taste, and problem-solving skill—factors that defy quantitative measure—must be given significant weight in the final structure of a firm's objectives.

In recent years, ideas about how to measure design quality have proliferated. For example, whether explicitly stated or not, some firms' objectives include one or more of the following:

- *To do something innovative or newsworthy on each project*. This is a common goal of firms focusing on establishing a reputation.

- *To redefine the traditional design response to a particular building type*. This is a goal for many firms with specialized institutional practices (schools, hospitals, etc.).
- *To design buildings that emphasize the functional, maintenance, cost, and other performance objectives of the owner, rather than aesthetic criteria*. This is perhaps the objective of some office, hospital, and housing specialists.
- *To consistently impose on each project a single design theory or vocabulary*. This goal is common among firms dominated by a single strong personality.

No doubt you see the point: Regardless of what your design goals are, once they are defined, they will influence how your firm approaches its work, allocates its resources to a project, guides and judges its own design efforts as the projects develop, selects and develops staff, and deals with many other issues that affect design quality.

Recognizing the Impact of Practice Mix on Design Goals

Design goals, are, as stated, directly affected by a firm's projects. Therefore, the type of projects a firm gets is usually a function of what the firm seeks. If a firm wants to establish a strong design reputation, it must find a way to obtain work from clients with the desire, budget, and program to generate public interest and make design excellence possible.

Obviously, it is far more difficult to build an image from completing, say, small additions to proprietary nursing homes, small industrial buildings, or low-income housing than it is by designing a corporate headquarters building or a college performing arts center. How a firm selects the type of work it

wants, and then secures it, was covered in Chapter 2. The point here is that the realism, and even the definition, of the firm's design goals are in large part dependent on the direction and success of the firm's marketing efforts.

Moreover, a firm's design goals must address the needs of the building type and client. Different building types generate very different design constraints. These differences must be reflected in the firm's design philosophy and process. High technology, code-constrained programmatic buildings, such as hospitals and laboratories, often present more difficult esthetic challenges than those of an office building or a luxury condominium, where a different combination of a client's decision-making process, program, budget, and technical priorities govern.

More than one solid, old-line firm has seen its reputation damaged by breaking away from its roots to embrace design philosophies and processes that are incompatible with its traditional projects' needs. This is usually done in a misguided attempt to rapidly upgrade design quality and image. A typical sequence is:

1. The firm loses several projects in part because of a reputation for dull design.
2. The principals decide they must upgrade their image and skills.
3. The firm hires a designer from a "design firm," and tries to import new process as well.
4. The firm turns its back on the skills that brought in clients.
5. Its image fails to change and clients and old-time staff become alienated.
6. The design "savior" is fired and the firm reverts to its former ways, often in a weakened condition.

An alternative scenario is the following:

1. The firm hires a star designer.
2. The firm fails to alter its project delivery process or budgets to reflect the new, design-driven needs of the new "star."
3. The star designer resigns in frustration.

It is important to remember that design excellence is not imported, but instead requires a long-term effort directed from the top down and integrated with every aspect of the firm's activities. It is a firm's real goals, in conjunction with the projects it works on, that help establish the context for the development of a design process.

Designing the Design Process

The term *design process* is used here to refer to the way a firm allocates and controls its design resources (people, consultants, time, etc.) and manages them to execute a project. To improve design quality and efficiency of the project team, as well as to promote meaningful interaction between the client and the project team, time must be spent on designing the design process.

For each of the participants (owner(s), architect(s), consultant(s)), a clear, well-documented and agreed-upon definition of this process will include:

- Scope of the work
- Schedule
- Work plan

The work plan serves to organize the efforts of the team and is a vehicle for communicating the sequence of these efforts to the client. Note, however, there are major differences even among "design-oriented" firms in this area. Some of the typical ones are:

- *Length of time devoted to each phase.* Some firms spend far more time in program and site analysis; other firms allocate as much time as possible to schematic design and design development; still others are careful to allocate adequate resources to the late design-development, contract-document, shop-drawing, and field phases, in the belief that "God is in the details."
- *Who does what.* In any design-oriented firm, the proper matching of staff with projects is the critical first step in the successful execution of the project. Some individuals are better at small projects; others are best in design development; still others are good at working through complex problems. The natural tendency is to make do with the staff available. This, however, can result in the most important projects being assigned to staff no one knew what to do with, since they are available because the best design talent is busy on other projects.

  Asked what his most important job was, legendary ice hockey coach, Scotty Bowman, replied: "To get the right players on the ice."

  QUOTED IN *THE GAME*, BY KEN DRYDEN

- *How each phase is carried out*. This refers to decisions about when to involve engineers, which tools (models, renderings, etc.) to use during the design phase, how to study the key design issues, and how to resolve these issues.
- *When to involve consultants.* Most architects will, when asked, say they like to involve engineers at the beginning of design, but in practice, many do not. Moreover, many engineers discourage such early involvement because they

want to do the job only once. Still, failure to seek creative engineering input early can significantly affect the development of a building design.

- *How progress is monitored.* At specific times during the development of a project, there is a need to pause for a review. The firm must decide when these reviews are needed, how they should be structured, and who should participate. Sporadic reviews by poorly briefed principals that result in a lot of rework are all too common and often give reviews a bad name. Well-run design firms find some way to provide regular review and participation by the firm's design leadership. In sum, these reviews should evaluate progress based on the management, design, and technical goals established for the project. They should suggest areas for further study and establish guidelines for further development. In an environment where clients want projects "yesterday," it is tempting to cut out the so-called soft parts of the design process, and the design development phase is the most typical victim today. Ironically, it is during this phase that some important details require extra time to work out. What a shame it would be, for example, to see a separate accounting for a chair rail detail that was a central theme in an interiors project because it took several weeks to resolve. These soft periods are often gestation periods, when the design concept matures. Or firms are faced with the need to rethink a design—a decision that cuts into fee budget, project schedule, and client patience. The firms with design ambitions are

careful to preserve their flexibility in all aspects of the process in order to bring additional skills, time, and effort to a project when necessary. These factors can all play a role in effectively focusing the resources of a firm so that the design concepts established by the principal designer can result in an excellent completed work of architecture.

- *How the firm deals with other members of the project team.* Over the last several decades, the size of teams has grown and the roles and responsibilities have changed. Now, many specialist consultants, owners' reps, construction managers, and others have direct access to the client. Almost every firm today has lost some important aspect of the project design decision because of the advice of one of these other team members. Conversely, in an era of skeptical clients, a united front of architect and construction manager or other consultant can often serve to resolve an important design issue. Therefore, how a firm controls the entire project team—in particular its relationship with the source of such key owner concerns as cost and time—will have a great impact on the success (or failure) of a given project.

Organizing the Firm

Communication and interaction are central to the effectiveness of every aspect of the design process. In simpler times, when the problems, the project, and the practice were all on a smaller scale, the practice of architecture could be based on individual intuition. Today, with larger projects, complex functional,

technical, and environmental problems, and larger groups of client/architect/consultant teams working to solve these problems, organized and effective communication and interaction are imperative to success.

Some firms—even some large national ones—try to centralize design in the hands of a single person. And though management theory says that most individuals can control only the details of four to six complex issues (such as design projects) at one time, this has not deterred some architects from trying to handle more. Centralization of design decision making is normally most effective only in small firms; it is difficult to achieve in large ones.

Medium and large firms usually take one of three more decentralized options: *departmental*, *project team*, and *studio*. The first breaks the project into specialties—often with different specialists or departments doing the planning, programming, design, production, and construction administration. Under this option, a project manager weaves the common thread throughout each project. The second option has a single team take the project from planning through construction, with specialists and draftspeople added to the core team as required. The studio is an expanded team, with most or all of the skills and personnel to handle several projects organized under a single design/management leadership.

All of these options (and variants) have their advantages and disadvantage. The central organizational issue, with respect to design quality within each option, is the role of the principal designers. More specifically, do designers or managers control decision making for the project? On this point much blood has been shed. If it is not the designer, how do

important design decisions get made? Is the principal designer involved throughout the process?

Firms that confine the principal designer to schematic design and design development have been compared to multistage rockets with each stage controlled by a different guidance system. The satellite may get launched, but not necessarily into the orbit intended by the first-stage rocket. Peter Samton, of the Gruzen Samton Partnership, did a study of how a few of their more respected competitors organized themselves to achieve design quality. While his sample was limited to relatively large firms (with more than 100 staff), his conclusions are relevant for most firms:

- Design excellence is achieved only when there is effective design leadership at the principal level throughout the process.
- All firms studied were very concerned about process, organization, and most of the other issues covered in this section, and were working to find the right approach for their firm.
- No two firms were identical in the way they achieved excellence, but all had found some way to address each issue.

Managing Clients

A key figure in any project organization is the person who manages the client relationship, whether that person is the principal designer or someone else. The design quality of many projects is often won or lost depending on who fills this role. On some projects, it is easier to go along with a client's wishes than to defend a design solution the client does not support. But while it is easier to "ride a horse in the direction

it is going," this decision can often lead to a compromised design concept.

Few owners today accept their architect's design decisions unchallenged. Often, owner opinions directly cause key budget and esthetic trade-offs. If there is no one on the architect's side who understands what is important in the design, and who can sell it to the client, many of the firm's design ideas will fall prey unnecessarily to unsupported arguments based solely on "taste" or budget. This does not need to happen. An understanding client is essential to a good result, and it is part of the architect's job to gain this understanding. To quote Eero Saarinen, "Let's see if we can make this guy into a great client."

One popular architectural argument says that good design does not necessarily cost more. This is often true, but unfortunately it is also true that the heart of many designs has been cut out in last-minute budget reductions because of poor client and construction cost management. Many budget reductions also alienate clients, who end up feeling misled by their architects and lose the essential quality they, too, had counted on. Thus, the careful management of client expectations and project budget are critical to design.

Another essential part of the client management process is the effective communication of the design team's ideas and recommendations. Whoever presents the design must be supplied with adequate visual and technical support to make his or her arguments. It is no coincidence that the best-known design firms typically produce the most compelling design presentations.

Building a Public Image

Obtaining client support for a design proposal is easier, of course, if the firm has a strong reputation for design excellence. When dealing with a recognized design talent, clients generally defer to their acknowledged architectural judgment. Design image also has the more tangible reward of attracting more notable clients and talented staff. This has always been true, but it appears to have become even more important in recent years. The success of developers, such as Gerald Hines, together with a growing public interest in architecture, has made being a design celebrity an important competitive asset.

That said, design celebrity is often created by others, as much as it is earned. Several of the best-known design figures today gained fame before they had completed more than a few houses and small interiors thanks to their promotion by others with power in the market. For example, a former Zeckendorf executive recounted how Zeckendorf promoted his young in-house architect, I. M. Pei, so effectively that Pei was listed among the nation's leading architects before a single one of the projects that later earned him his well-justified reputation was off the drawing boards. Others, far less worthy, are now striving to equal that remarkable public relations achievement. The lesson here is that even a local design reputation requires an active effort at self-promotion.

What is more, self-promotion rarely can be based upon the reputation of an organization; today it must be tied to identifiable personalities. It is irrelevant that many of the buildings and designs that have been attributed to some of the nation's most prominent design figures were, in fact, designed by someone else; the focus of the reputation is almost always

on individual talent. This glorification of the individual is one of the reasons that larger firms have trouble building the type of multistar organizations common in other professions. It is also one of the reasons so few large firms have been able to achieve consistent design excellence. Architecture, as art, demands the identification of artists.

One of Brad's father's favorite stories told of Bill Caudill (founder of Caudill Rowlett Scott), who wanted to be pictured with his entire team for an article in *Life* magazine. The editor disagreed, saying, "Bill, everyone knows the MGM lion, but no one thinks he made the movie by himself." The editor was right, of course, about the public's understanding about movies, but not about architecture. The film industry is careful to identify and reward the many different talents that go into the complex task of making a great movie. Such is not yet the case in the equally complex task of designing a building.

Image-building methods employed vary considerably, but those used most often today include:

- Cultivation of the press.
- Aggressive publication of the firm's work. (In more than one case this has involved subsidizing a publisher to produce a book on the firm.)
- Active participation in the design establishment's activities: teaching, speaking, preservation efforts, art openings, panel discussions, juries, and the like.
- Organizing architectural exhibits or writing about architecture, featuring one's own work.
- Working to make the firm's office, graphics, and the other visual elements consistent with the desired image.

Of course, the time-honored methods of entering—and winning—competitions or design award programs are still among the most effective approaches. Being active and respected in the design community tends to increase success in competitions and awards programs. Merely creating an attractive submission is not always enough.

Promoting Design Talent

This brings us full circle. As stated at the beginning of the chapter, the most important figures in achieving design excellence are the lead designer and the design team that work on each project. No matter how good the goals, the projects, the process, or the salesmanship, great (or even good) design is possible only when you have a good design team led by a superior design talent.

Firms that have strong reputations have little trouble attracting such talent, but building a new organization, or rebuilding an older tarnished one, is a far more difficult task. In the latter case, the firms that have done so have had to aggressively seek out, train, and integrate talent into established organizations that may have had powerful antibodies to resist change. At the very least, this takes several years to accomplish.

It is very rare to see a firm such as C. F. Murphy (now Murphy/Jahn) emerge quickly as a design leader. The large staff layoff at SOM following completion of the Air Force Academy, however, combined with the Richard J. Daley-directed load of public work gave that firm an opportunity for staff and projects with real design potential. They took this opportunity and ran with it. Some firms have tried the quick fix by importing outside talent to lead

the design effort. More often than not this has failed because the effort stopped with the hiring of one or two stars. As many expensive free agents in baseball have proven, a few stars are not enough to make a winning team.

Conclusion

As with any other aspect of successful architectural practice, consistent design excellence cannot be achieved by accident. It is the product of an intense multifaceted effort. At the core of a successful effort is an individual (or individuals) with design talent in a leadership role. But though essential, a strong leader is not enough to achieve consistently high design quality. Consistently high-quality design is also a central management issue, and as such it should be built into the firm's plan for the future.

Potential Causes of Failure

10

Most books and articles on architectural design focus on how design firms have risen from obscurity to prominence. Few address the equally instructive, if less popular, subject of why some firms fail. There are, of course, many types of failure: failure to achieve the principals' major objectives; failure to achieve a firm's full potential; failure in the form of complete organizational collapse; or just going broke. Fortunately, it is possible to trace the origins of most failures to one or more flaws in the leadership of a firm, and such an investigation can teach founders of new firms a lot about what to avoid and how.

Some flaws are noble, worthy of a Greek tragedy, but most are petty or avoidable. Both the noble and the petty are discussed in the following sections with examples of the common pitfalls presented as brief case studies.

We have distilled the most common causes of firm failure to a list of 10, introduced in the following list, then explored one by one in the following sections.

NOTE

All the case studies presented in this chapter are composites of real situations, but sufficiently disguised to be unrecognizable.

1. *Halley's Comet*: Believing a brief run of luck means you can coast.
2. *The Buggy Whip*: Ignoring the cycles inherent to most specialties.
3. *The Grass Is Always Greener*: Ignoring client/market base to pursue other practice areas.
4. *Cannon Fodder*: Treating key people as expendable.
5. *The Captainless Ship*: Failing to replace a strong leader when he or she retires.
6. *Peter Principle by Primogeniture*: Bringing unqualified relations into the firm's leadership.
7. *Swollen Heads and Feet of Clay*: Relying too much on strengths while ignoring weaknesses.
8. *Financial Management According to the Russian Politburo*: Managing finances incompetently.
9. *Losing Sight of the Big Picture*: Failing to market when busy.
10. *Sometimes the Batteries Run Low*: Running out of energy.

Case 1: Halley's Comet

Probably the most commonly seen form of failure is the firm that has a brief run of luck and then disappears.

Firm A spent 10 years building a reputation for consistent quality on a series of small commissions. The three principals all worked directly on each project and developed a growing list of happy former clients. Then they obtained a "dream" commission, a major project for a client willing to support an innovative design solution. The architects made the most of the job, and following favorable publicity, rapidly became a "hot" firm. As more big projects came their

way, the office grew from 10 to 60 people in two years. That's when the problems began.

Too soon, the principals began believing their own publicity and playing the role of "stars." At the same time, they spread themselves too thin—a problem aggravated by their loss of interest in the details of new projects. They spent more and more time enjoying the fruits of their prosperity. Quality became inconsistent and client loyalty weakened. No organized business development program was created. As a result, when a recession hit, their work dried up, they shrank quickly back to a 10-person firm, and eventually faded into obscurity.

Case 2: The Buggy Whip

The design professions are competitive, cyclical businesses. This means a firm can never rest on its laurels, and must be in a position to respond to changes in the market.

Firm B built a strong practice in educational and other public building types in the 1960s and 1970s. The principals were confident their prosperity would continue and so regularly spent the firm's profits. Unfortunately, school populations began to decline, the economy slumped, and local tax revolts applied the coup de grace to their traditional markets by the 1980s. The firm found itself without work and without the financial strength to rebuild in another area of practice.

Case 3: The Grass Is Always Greener

Unlike Firm B, many firms are never satisfied with their current areas of practice. This, too, can lead to problems.

Firm C acquired a strong reputation for planning studies, which occasionally led to architectural commissions. Even though the firm's finished buildings never matched the quality of their predesign studies, the principals wanted to be architects, not planners, so they ignored their study work and put their efforts into getting design commissions. The basis of their reputation soon shifted from excellent planning to mediocre architecture. With this shift came the beginning of their decline.

Case 4: Cannon Fodder

It is good advice to anyone who thinks him- or herself irreplaceable to observe what happens when he or she withdraws his or her finger from a bucket of water. Unfortunately, this lesson has often been translated into the belief that everyone is replaceable, which, in the short term, is not necessarily true.

Firm D prospered for years under the leadership of a man who made it clear that he believed the "everyone is replaceable" axiom. Over time, the firm's reputation became more dependent on the principals who were carrying out the projects (as is generally the case today), but the founder never recognized their growing contributions or shared the fruits of the firm's success. Then a crisis came, and the key principals, who felt no loyalty to the top man, left the firm, taking their clients with them.

Case 5: The Captainless Ship

A variant on the loss of key personnel is the forcing out or failure to replace the person or persons who built the firm.

Firm E's younger partners breathed a sigh of relief when their concerted efforts finally compelled the domineering founding principal to retire. In reaction to his autocratic approach, they decided to manage by committee. All of the committee members were "inside" men who frowned on the founder's egomaniacal and wasteful interest in speeches, parties, travel, and other "nonproductive" efforts. Eventually, though, the committee found that, in the name of prudent management, they had, essentially, "lobotomized" the firm. Devoid of its personality, and constipated in its decision making, the office muddled its way into mediocrity.

Case 6: Peter Principle by Primogeniture

Like many parents, design professionals often want to pass on what they build to their children. The desire to hand down the leadership of a firm is understandable, but often ends up being a disservice to both the child and the parent-architect's colleagues who helped create the legacy.

Firm F—compelled by the insistence of its founder—promoted the founder's son to fill his father's place upon retirement. The merit of this promotion was not convincing to either clients or key staff, who soon departed.

Case 7: Swollen Heads and Feet of Clay

It is far truer to say that "no one person is a complete design professional" than "no one is irreplaceable."

Firm G, for example, built upon the sales skills of its principals. Unfortunately, its other skills—in

design, production, and the many other capabilities necessary to serve a client properly—were not comparable. Ultimately, the principals ran out of new clientele.

Firm H, in contrast, built its reputation on design expertise, but like Firm G, never balanced its forte with other requisite skills. Tough competition and bad references cut short their moment of success.

Achieving balance is a challenge for most design firms, often because of big egos and a lack of respect for the full range of skills required to achieve excellence. Too many firms have been led by individuals who could not tolerate equals, or, when they could, had too little respect for skills other than their own to tolerate full partners with balancing capabilities.

Case 8: Financial Management According to the Russian Politburo

The financial rewards of the design professions are rarely comparable to those of other professions and businesses. Regrettably, many design professionals do not recognize this fact.

Firm J grew and prospered, and its principals' tendency to spend grew with it. Personnel were hired in advance of need, offices were outfitted in a manner consistent with the firm's design tastes, and personal spending by the principals centered on slow whiskey and fast cars, sailboats, and women. This expensive lifestyle was financed with borrowed money and a failure to pay consultants money they were owed. In time, Firm J's credit ran out, it was nearly forced into bankruptcy, and it suffered a general dissolution of its reputation and practice.

Case 9: Losing Sight of the Big Picture

It is very easy to lose sight of long-term issues when working hard to meet current client deadlines. It should be remembered, however, that successful firms are always hungry, and they never forget that continuous marketing is a constant priority.

Firm K built a busy practice, whose principals focused all their energies on their current workload, even to the point of ignoring or turning down potential new commissions. When the projects all moved into construction and the fee volume dropped precipitously, a financial crisis ensued. The firm could not cut costs fast enough to respond to the drop in revenue and no new work had been lined up to fill the gap. It took the principals 18 months to rebuild, but the firm was so financially and psychologically weakened that it never recovered its earlier success.

Case 10: Sometimes the Batteries Run Low

Building and maintaining a successful practice requires consistent effort. It never gets easier, and the more ambitious you are, the harder it is. But even successful design professionals can burn out. After a period of success, they begin to focus on other priorities or just run out of energy.

Firm L was dominant in its county of practice. A large percentage of the major corporate, institutional, and private clients automatically considered them when they had a project. The firm was led by one principal, who was a talented designer and an effective leader; the other principals all had strong complementary capabilities but none the same as

those of the senior partner. When the senior partner began to phase down and take more time off away from the office, no one could fill the void. Soon, the firm earned the reputation of being in decline, with a leader soon to retire. The firm survived only by being absorbed into another firm that could provide the absent leadership.

Lessons from Case Studies of Failure

A full list of lessons implicit in the case studies just described would require its own book, but the more important ones and their management implications can be summarized as follows:

- **Make a consistent effort to achieve excellence in all areas.** For a firm to achieve and maintain success, it must recognize that it has to be skilled at both the professional and the business aspects of architecture. In the simplest terms, a firm has to sell well, provide consistently good service on the projects it sells, and manage both its projects and its office in a way that generates a profit. There is no significant margin for error in today's competitive, demanding-client, low-profit-margin world.
- **Conduct a realistic self-appraisal.** To manage the basics well, the firm should have a plan that establishes goals, realistically assesses its own strengths and weaknesses, and then outlines logical steps to build on these strengths and overcome the weaknesses in the pursuit of the goals. This requires an *honest* self-appraisal—which is not easy, because too many

design professionals begin to believe their own press releases.

- **Steadily follow a well-planned business development program.** Successful business development is usually directly related to a realistic plan, a strong reputation in a good market or markets, and ongoing efforts to develop new leads and sales. It is important to remember that once a strong reputation or momentum has been achieved, it must be maintained. Few firms are ever given a second chance. In addition, as illustrated in Case 3, a firm should not abandon an area of strength or even dilute its impact. As already noted, any expansion into new areas must be carefully governed and monitored by a realistic plan to eliminate weaknesses while building on existing strengths.
- **Be sensitive to changes in the marketplace.** A realistic plan and effective business development program must also recognize that the market is dynamic, not static. No firm can depend on one building type or a long-standing reputation to carry it into the future. Today, the pace of change in all things is accelerating, and firms must change, too, if they are to stay viable.
- **Structure an organization that can carry out the work.** The firm's organization must be structured to respond to the new work produced by business development. This means not only having the full range of technical skills required to provide excellent service, but also focusing these skills on the right problems. In Case 1, for example, the firm did not build a structure—one with new partners or a strong middle management—capable of accommo-

dating the additional load created by growth. The one- or two-leader firm is particularly vulnerable today as clients become increasingly demanding of personal commitment and error-free service.

- **Attract and hold key staff.** Any firm seeking to grow must create a structure that attracts and holds the best available person in every key position. The principals of the typical architectural firm should take a lesson from leading attorneys, accountants, advertising agencies, investment bankers, and other firms, where there is room for more than one "star"; and in the best of them, each major position is held by a specialist whose reward and status are based more on his or her contributions to the firm's success than on an arbitrary professional caste system.

  Principals should not be afraid to take on additional partners, officers, or principals. As service firms in other professions have repeatedly shown, the proper choice of additional partners to fill leadership openings can expand both the financial "pie" and the quality of the service. A partner in any category who pulls his or her weight costs nothing.

  Partnerships and other principal ties are primarily business relationships—ideally, but not necessarily—strengthened by personal ties of friendship and respect. Because they are business relationships, they can be severed with far more ease than most people assume. But these relationships should be made—or severed—primarily for business, not personal, reasons. When personal jealousies, family loyalty, or

other emotional issues interfere in such decisions, the results rarely benefit anyone. One of the primary roles of a firm's leaders must be to minimize the inevitable petty personal differences that can sow the seeds of the firm's destruction.

- **Plan carefully for changes in senior leadership.** Probably the most dangerous period for any firm occurs during the transition of leadership from the founder(s) to the next generation, or, as is more common in a young firm, the departure of a partner. It is at this point, more than at any other, that a realistic plan and assessment of strengths and weaknesses must be made. The holes left by the departing leaders, as well as the actions necessary to fill them, should be identified.
- **Apply the "why not the best" principle.** The "why not the best" principle should be applied when hiring to fill all positions. Failure to clear out dead wood is almost as serious as neglecting to keep staff levels closely related to the volume of work available. Given the limited fees received by most design professionals, it is imperative that funds be spent on productive personnel. This does not mean, however, to follow a hire-and-fire philosophy, as then it will be impossible to form the bonds of loyalty and respect among principals and staff that are essential to the building and maintenance of a productive, stable staff of quality personnel. Always remember that the best staff have the most options and, without good reasons to stay in their present position, will be the first to exercise those options.

- **Manage personnel costs carefully.** Because salaries constitute almost two-thirds of most design firms' expenses, and are the most easily adjustable segment, they must be the focus of financial control. Most firms—with or without such controls—make money during periods of rapid growth because personnel and other expenses usually do not catch up with volume. With controls applied to personnel, however, the other easy time to make money is when month-to-month volume remains steady and relatively little effort is required to keep all technical personnel billable. Unfortunately, few firms ever enjoy such conditions. Most experience wild swings in volume and need to expend a growing percentage of their resources on securing new work. These conditions, combined with narrow profit margins, leave no room for error or waste.
- **Recognize the importance of effective, conservative financial management.** Above all, a firm must make money to grow and prosper. To make a profit, the primary effort must always be directed at balancing volume and expenses. This requires coordination of business development, project scheduling, and staffing. The closer a firm comes to achieving a consistent balance, the more likely it is to make a profit. Financial management must, of necessity, be conservative. Owing to the cyclical nature of the building industry, it is essential that a firm accumulate cash reserves to weather the inevitable crises. There is no room for any personal behavior that wastes the firm's (and its creditors') resources on personal expenses. Too

many people are hurt by such actions. Effective financial management is impossible without formal controls on volume, expenses, and cash flow.

Final Points

Of course, even the strictest adherence to all of the precepts given here cannot guarantee that a firm will achieve success or avoid failure. After all, management is not the raison d'être of a design firm. Unfortunately, as the case studies illustrate, a weakness in any management area can cause failure, and only superior professional capability can ensure success.

11 Launching Your Firm

Now that you have the outline of a plan and a working knowledge of the basic issues covered in the preceding chapters, it is time to decide when (or, indeed, if) to launch your firm. As Massachusetts architect Earl Flansburgh wrote, "There is no good time to start a new firm, only better times." Obviously, it is usually easier to get started in a booming economy, when there is a lot of work, but many successful practices started during recessions. Brad's father's firm, Perkins & Will, was founded during the Great Depression. He considered it, on balance, a good time to start, because as the economy recovered, clients were willing to consider new, younger firms since so many established firms had gone out of business.

Two typical triggers usually are enough to get a new firm off the drawing board and into practice:

- The belief that the firm can get work
- The assumption that the principals have the resources to survive the limited cash flow of a start-up

If both these basics are in place, most new firms then must quickly implement the following steps:

1. Decide on whom, if anyone, you want to work with.
2. Decide on a start date.
3. Draw up a business plan that includes:
   - A vision statement and a list of goals for the first year
   - A description of the services you intend to offer
   - A list of sources from which work will come
   - A budget for the start-up costs and for the first 12 months
   - An initial cash flow projection to define the initial capital requirements
   - A list of the support you will need to provide your services at the desired level of quality
4. Obtain initial clients and identify the probable source of the next clients.
5. Verify that you have met the necessary legal (licensing, corporate registration, etc.) requirements.
6. Choose a name, design business cards and stationery, and plan other actions that will help set the right image.
7. Obtain start-up capital.
8. Decide where to locate.
9. Select advisers: legal, financial, insurance, general business.
10. Promote your practice: send out announcements, call friends and former colleagues.
11. Set up the office: equipment, a basic accounting system, telecommunications, files, stationery, and so on.
12. Identify back-up resources: administrative and technical.
13. Begin practicing.

Now let's consider these steps more closely.

Partners and Associates

One of the most critical decisions you have to make is whom, if anyone, you want to work with. As discussed in earlier chapters, it is unusual that an individual has every skill necessary to lead and build a successful practice. There are exceptions, of course, such as firms led by sole practitioners who have chosen to focus on smaller projects that can be successfully carried out by a single design professional. But most practices with more far-reaching ambitions have to consider the question of partners.

The classic leadership mix for a new firm unites individuals who—in combination—have:

- New business development skills to get work
- Technical skills to successfully complete the work
- Basic management skills to keep the practice solvent

Ideally, each of the firm leaders will appreciate the importance of, and participate in, all three of these basic responsibilities.

Launch Date

It is important to set a date to start up the office, for, as with most deadlines, it imposes a degree of discipline into the planning and preparations.

There is little conventional wisdom regarding the best time of year to start a firm. If your plan calls for an immediate major effort to see potential clients, August and December might not be good choices because many people are away. September and Janu-

ary, however, are both good times to find people back at work.

In any case, often external factors—the need to sign a lease on office space, a first client who wants you to begin work immediately, or even losing one's full-time job—will override the selection of an arbitrary date.

The First Business Plan

In every chapter of this book, we've emphasized that a firm's future should be built on the foundation of a plan, and the first-year plan is often the most important.

The first vision statement for Brad's firm has changed significantly over time. When they started, the principals wanted to be the project architects on all jobs. As the firm grew, this had to change. But what did not change was their commitment to remain focused on building types where their research, experience, and other sources gave them a knowledge base and real expertise to bring to each new challenge. The initial vision remains a core belief for the firm.

Definition of Services

It is important to formulate a clear statement of the services you intend to offer. Labels such as "Architecture" or "MEP Engineering" might be sufficient in a small town, where you have to be a generalist, but in most other locations, you should differentiate yourself and begin building a supportive image. If you have special skills or interests, make sure you emphasize them.

It is also imperative that you offer services that you can deliver—and well. This does not mean that you should hesitate to offer services that you have not done before, just be prepared to do whatever it takes to do them well.

Location

Many new, small firms are launched from the founder's home. Often this is the only financially viable alternative, but it comes at a cost. To be efficient, most of us need a clear boundary drawn between home and work. Moreover, you are more likely to be viewed as a serious practitioner if you have a "real" office.

First Clients and Marketing Plan

We strongly recommend that you launch only after you have the clear promise of work and a plan to get more work in the future. As described in Chapter 2, avoid taking unethical advantage of your former employer, but recognize that most new firms are planned while the founders are working for someone else. Marketing and sales are ongoing processes, and few firms can afford to wait to start these processes until the day they open their firm.

First Budgets

Two budgets are essential parts of the plan: one for the start-up costs and one for the costs for each of the first 12 months. These budgets, of course, should be tied into a realistic projection of cash flow and calculation of your capital requirements. (See the "Start-up Costs Checklist" at the end of this chapter for more on this.)

The Opening

Stage the opening of your office as an event. Give a party and send announcements to all of your family, friends, past clients, professional contacts, and anyone else you can think of.

With these decisions made, and a plan and resources in place, you are as ready as most design professionals when they started. If your firm is successful, you will have a constantly rewarding and challenging career. Good luck.

Start-Up Costs Checklist

Expense	Estimated Cost	Actual Cost	Date to Pay
Business license/permit(s)			
Professional license			
Business opening announcement			
Rental deposit on office (if not in home, two months' rent)			
Telephone installation/deposit			
Answering service			
Utility deposits (if not in home)			
Internet service			
Insurance			
Health			
General liability			
Professional liability			
Valuable papers			
Life			
Theft			
Hazard or tenant			
Disability			
Auto			
Legal			
Initial consultation			
Form of business papers			
Accounting			
Initial consultation			
Format resolution			
Professional association dues			
Local			
State			
National			

Expense	Estimated Cost	Actual Cost	Date to Pay
Initial Business Brochure			
Letterhead/business cards			
Equipment/furniture			
Computer hardware			
Computer software			
CADD software			
Typewriter			
Drafting desk(s)			
Desk(s)			
Adding machine			
Lamps			
File cabinet(s)			
Flat file(s)			
Conference table			
Chair(s)			
Telephone			
Telephone answering machine			
Facsimile machine			
Car phone/pager			
Photocopying machine			
Diazo machine			
Coffee machine			
Reference library (code books design books, this book, etc.)			
Library shelving			
Supplies			
Pens/pencils			
Markers			
Mylar			
Bumwad/tracing paper			
Vellum			

Expense	Estimated Cost	Actual Cost	Date to Pay
Drafting tape			
Paper clips			
Post-Its®			
Legal pads			
Telephone message pads			
Computer disks			
Light bulbs			
Measure tapes			

APPENDIX

A

Study Guide

This book was written with the intent that it might also serve as a text in the practice or management course contained in most design curricula. To that end, and based on our experience teaching this course and lecturing in other similar courses, we suggest a number of projects that can assigned to reinforce the lessons conveyed in this book. Specifically, we have found the following 13 study projects to be of value to new design professionals:

1. Define the type of firm they want to have in year 1, year 10, and year 20.
2. Write a job description for a prospective partner. Include general responsibilities, specific duties, professional requirements, and personal qualities.
3. Describe the qualities you would expect future potential leaders in the firm to have. Indicate how you would go about developing or reinforcing those qualities.
4. Think about, then write, your own obituary, as you would like it to be written about you. Consider both personal and professional aspects.
5. Design a brochure, using material from the Web or from other media, to describe your

theoretical firm in its first few years, and after 10 years.

6. Using readily available sources—local newspapers, the chamber of commerce, the local planning departments, and others—identify 10 projects coming up in your geographic area for which no architect has been chosen.
7. Develop a proposal from your theoretical firm for a new day-care center (or other project to be defined).
8. As part of the proposal develop a detailed schedule, labor projection and fee computation for the project. Include fees for each of the other disciplines (structural engineering, landscape, etc.) that should be included on the team.
9. Prepare and present a PowerPoint® or other form of presentation for the project.
10. Fill in the standard form of contract, AIA B-141, and add at least 10 clauses that you think should be included in a contract for this project.
11. Work with three of your classmates to define a team for the project, then outline the team's organization and structure. Include several different services that you feel would benefit the client.
12. Pick an ethical issue, research how it might occur, and discuss the shades of gray inherent to it.
13. Develop a mission statement and business plan for your theoretical firm.

APPENDIX

B

Charting Your Course*

[Text not available in this electronic edition.]

About the Authors

Peter Piven, FAIA, is a founding principal of The Coxe Group, Inc., the oldest and largest multi-discipline firm providing management consultation exclusively to design professionals.

Mr. Piven received a Bachelor of Arts degree with High Honors from Colgate University, a Master of Architecture degree from the University of Pennsylvania, a Master of Science degree in Architecture from Columbia University, and a Certificate in Management of Design Organizations from Harvard University.

Before becoming a full-time consultant, Mr. Piven was a vice president of Caudill Rowlett Scott, and then principal of Geddes Brecher Qualls Cunningham: Architects. He was the founding chairman of the AIA Financial Management Committee responsible for producing virtually all the financial instruments for the profession. With Brad Perkins, Mr. Piven instructs "Starting a Design Firm" at Harvard Graduate School of Design's Executive Education program. He is also the author of "Financial Health" and "Acquiring Capital," in the current edition of the *Architect's Handbook of Professional Practice;* and *Compensation Management: A*

Guideline for Small Firms and is a coauthor of *Success Strategies for Design Professionals.* His book *Architect's Essentials of Ownership Transition* was published by John Wiley & Sons, Inc., in February 2002.

Bradford Perkins, FAIA, OAA, AICP, is the president of Perkins Eastman Architects, a firm he founded in 1983 after serving 10 years as a principal in three other national firms, and several years working with two national management consulting firms. Perkins Eastman has grown from a start-up in New York City to a 400-person architectural, interior design, planning, and landscape design firm in seven cities in the United States and Canada. He has an MBA from Stanford, in addition to a history degree with high honors from Cornell, and an architectural degree earned after studying at both Cornell and CCNY.

Mr. Perkins is the author of *Building Type Basics for Elementary and Secondary Schools* and the "Building Design" chapter in *The Architect's Handbook of Professional Practice*, both published by John Wiley & Sons, Inc. He is also the author of two dozen articles on design firm management in *Architectural Record.*

Much of what Mr. Perkins has learned and applied in his practice is due to the experience passed down by his grandfather, Dwight Heald Perkins, FAIA, who established his own national firm in 1894, and his father, Lawrence B. Perkins, FAIA, who founded Perkins & Will in 1935.

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