ESCAPING THE GIANT CLIENT SYNDROME

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When I started my consulting business, it was the result of an economic decision by a prominent university, to close down the commercial arm of that main campus. This commercial entity was responsible for the commercialisation of intellectual property emerging from all of the departments across the University.

Internally, the vice chancellors made a political decision to axe the Department and I went from employee to independent contractor, in less than a month.

I couldn't believe my luck. I had been given a consulting contract, with twelve projects, each funded for the following twelve months by the University. I could work my own hours and didn't need to attend any office if I didn't want to. The university even provided me accommodation, though because of the scarcity of parking, I chose not to take it. For the first time my life, I was the boss and I enjoyed the feeling. I did my fair share of long lunches, but mostly I focused on the work and got the job is done. Life was good.

For the first year as a contractor, I only had one client - the University. Within the first few months, I immediately recognised the danger of this, having been a victim of political machinations in that same institution, in the past.

In my free time I set out to diversify my client list and within two years, I had built a sensible and balanced business not too dependent on any one customer. I had a marketing degree and two decades of experience in establishing and cultivating business relationships, so I knew this was urgent and very important. I eventually spent three days per week doing my actual consulting and one day per week on marketing to make sure I had a diverse practice by the end of the first year, when my contract was due for renewal.

I suspected my contract would not be renewed, as I saw the investment in my services by the University as a political flag-waving exercise; I felt they wanted to show the tenured professors, that professional IP marketing services were being provided for their projects.

At the end of the first year of my sub-contract process, the funding for each of the projects was not continued. That business I started all those years ago still functions today because I did not fall victim to this ***giant-client syndrome***. At the beginning of the first year I had one client. They represented 100% of my business and the negotiated terms by which I conducted my practice was on a two-page contract with the Vice Chancellor of Research of that institution. I thought I was free, but in fact I was bound up tighter as a subcontractor than I was as an employee.

Many consulting engineering practices get their start when one or some employees or senior management, took a package from their main employer and then contract back into this employer. This provides a win-win situation for both parties, but does not give control to the new business. There are two major problems that these new business owners experience almost immediately.

The first is that they cannot change the rules by which they were engaged, and that these rules are almost the same as when they were employed, except there are more responsibilities with payroll, insurances and other liabilities. The second is they have no asset value in the business, while it has the single client. Any potential purchaser will recognise the vulnerability of any business that has more than seventy percent of its business trading tied up in one client. In many cases these consulting engineers are contracted to major resource companies and projects, which in turn are subject to global commodity pricing fluctuations. This makes them vulnerable and they now have the flexibility to reduce their fixed costs by simply shedding contractors.

Contractual Control

Some of the negative attributes of giant client syndrome, include the negotiation for payment terms and the pressure to be flexible in implementing contracts by the smaller party. As recently as December 2013, I was advised by a client providing a substantial range of services to a large resource company, that they had closed their accounts payable for the year as at December 10. This meant any outstanding invoices, mostly due and payable around the 25th of the month, were to be paid in the following year. You can imagine the turbulance this caused for payroll and other essential expenses, which still needed to be paid within their due dates. This client was organised enough, to have a credit facility in place within days, so all personnel received their wages and holiday pay for the summer holiday season. The contractor had to take this treatment, because more than seventy percent of their business came from the single client. By December 2014, this will not be the case for this client and they will be able to be more forthright with the giant client, to ensure the contract is implemented as per the agreement. Fairness and equitability can disappear when contractual control rest with the one party, in this case the giant client.

Insistance on the Principal

Another negative attribute is the historical relationship that the principal of the small contract company generally has with the 'Giant Client'. This may be because in the past, this principle was an employee of that the company and secured this contract as a result of that relationship. Although that relationship is the core reason the contract company exists, it is also the single greatest danger when the principal tries to do what any good business person does and seeks to offload the core business activities to his employees. In some cases, the giant client simply rings the principal and reminds him that he is the contract, and they do not want other personnel - however qualified or competent they are, covering his duties.

More than a decade ago, I was pitching for a strategic planning project with the principals of a major accounting firm. They wanted their strategic planning done independently, and as I worked with their clients over several years, they were happy to have me do the strategic planning facilitation and the business plan write-up. When I turned up to the first scoping session with a colleague, the senior partner took me aside and very candidly expressed his requirement that I was to do the entire project and not have others in my team being involved.

In his words, he had indicated that "*if we are to pay top dollar, we want the top dog.*" This situation gave me no choice than to either take the project on as a personal contract, using my consulting time, or turn the project down. The client was a very important strategic partner of my business at the time, having referred many clients then, and even today. I did the project myself and in the process learned quite a bit more about the client, the individual personalities of the principals and the target industry they had identified as their niche. I also realised I had little leverage with this strategic partner.

Insistence on the 'Principal' or the person who the 'Giant Client' identifies as the one who has delivered effectively in the past, can be overcome and more quickly than you might think. A client of mine, Ernie, has an IT business which deals almost exclusively with BHP in delivering 'in-sourced' IT resources and consulting. He arrived at a point where he had had enough of dealing with all the problems and daily frustrations of working in this environment and was ready to close the business (knowing that with this Giant Client representing such a large proportion of his revenue his business would not be attractive to prospective purchasers).

I convinced him that together we could get him off the operational treadmill of working in the business and not 'throw the baby out with the bathwater' (this business was turning over around $1.5 million at a net profit of nearly 30%). In the next six months we had successfully promoted and transitioned one of his staff into a 'Manager' role which catered for about ninety percent of the tasks and time which Ernie was previously burdened with. Sure, there was some explanation and adjustment required on the part of Giant Client, but having the courage to adopt a strong position and providing assurance that the quality of work would not suffer allowed Ernie to free himself. Where he was previously on site for a minimum of forty five hours per week, he now spent most of his time 'fishing' and worked four hours per week remotely – very remotely, he moved to the north west of Western Australia where the fishing is extraordinary!

As a point of some interest, a very interesting thing happened when he made the commitment to get off the treadmill of working in the operation of his business: he regained the interest in and even passion about his business because his focus had become the 'big picture' and he no longer suffered the daily grind. In a mere eight months from the time we started working together (two months after he was no longer 'turning up') he had doubled the profitability of the business, all the result of him getting interesting in the important and strategic matters in the business and freed from the urgent and operational stuff. Getting off the treadmill was the greatest financial decision he ever made, not to mention 'lifestyle' and 'peace of mind'.

Changing the Guard

Several years ago, I was working with a client who was a large, national, listed company involved in providing products to the food industry. They had developed three very significant advances for the fast food industry, and were looking to establish themselves in that industry, with one of the leading players. Very quickly, they identified most of the leading players were global organisations, with no strategic decision-making being done in Australia.

We then looked at the list of Australian-owned fast food outlets, which were national and had substantial track record of sales, which could move sufficient product for us. We made our list of the top three players as our preferences and we approach the first one.

They were very excited about our product and the managing director entered into an agreement with this client firm, to independently validate the products, so their competitors could not claim these performed less than what we published. This meant finding independent laboratories and universities, to test the products and validate the findings.

This independent validation of the proof of concept took approximately 12 months to complete, and was partially paid for by this fast food client. They were as excited as my client was to deliver these significant advantages to the general public.

Then - it happened…………..

Their fast food company Giant Client, which was privately-owned at the time, was sold to a major private equity firm. This firm systematically changed the management of the company, and in doing so, replaced the advocates of our joint venture project.

As a result, our client (through no fault of their own) became a victim of politics and business change, in companies far removed from the original business relationship.

Worse still, there was a period of exclusivity associated with this agreement, which was tied to the investment contribution that the fast food company provided. This essentially prevented my client from marketing their range of products to the fast food industry in Australia, for several years.

This is one example of **giant client syndrome**. When you're business relies on the decision-making of one client for more than 70% of your revenue, you are essentially controlled by that client. In this case, a change of management meant that projected cash flows of millions of dollars per year - for several years, were never going to be realised. It took more than 6 months and some international clients, to pull this project back into a good place, which has since been reflected in the value of their listed shares.

No Leverage

Almost without exception, the single task that most service provider businesses hate most is the contract negotiation. Given that in most circumstances, the giant client has the control of the business relationship from the outset, it is always very difficult to negotiate a fair agreement for both parties, unless the other side can see your view. In some cases, the procurement or contracts manager who is renegotiating the agreement, has little or no experience in small business operations and does not understand the fixed and variable costs that a small business provider needs to plan and provide for. Unless the other party can understand these very real costs, they are not likely to accept that you are not taking super profits from the relationship. The most natural position that most contractors take, is to hide their business dealings and only provide necessary information in the course of the negotiation. Even though this makes tactical sense (the giant client may have your competitors as co-suppliers) it tends to make your presentation secretive, which in turn may reduce their perception of your trustworthiness.

In some cases, there is an expectation of exclusivity associated with the fact that some giant clients may imply that service providers who are also providing services to their competitors may be overlooked at the contract renewal stage. Although this cannot be stated in any contract, in most cases the "us or them" mentality of oligopolistic competition is just as emotive as it is financial.

I have a client which is a Civil Contracting company which derives most of it's income from Alcoa. Alcoa suddenly created a requirement that all service providers reduce their margins to ten percent and accept sixty to ninety day terms; requirements that could potentially sink many smaller outfits. What was extraordinary was that most of the service providers just accepted it without much of a challenge which of course made many operations 'marginal' and only just surviving.

My client was one of the only contractors to maintain their margin, as well as their present trading terms of thirty days. This was achieved by entering into negotiations with a clear objective of openly demonstrating the fixed and variable cost structures that drive the business to show that reduction in margin would compromise the operation, as well as establishing that real value was consistently being delivered by providing service, communication and quality which was beyond expectation. Successful negotiation with Giant Clients IS possible if you know how to go about it.

Having Giant Client Syndrome - What this Means

Having giant client syndrome in your business can be a very scary, and very dangerous situation for anyone. I recall some 20 years ago, when Apple decided to open up their own Apple stores across Australia. Up until then they had been selling Macintoshes and other Apple machines, through a network of dealers, who relied on the industry referrals from Apple and sales contracts to schools. Almost overnight, those dealers had no product to sell. In most cases, their competition had been IBM or Windows compatible machines, which they had been promoting as inferior to the Apple machines.

These Apple resellers then had to make a choice. They could either seek a distribution license for these Windows machines, or lose their livelihoods. It is interesting to note, that many of these Apple resellers chose to go out of business. Of the few that I know, most lost most of their savings and never recovered. No one can say that this is their fault. Unfortunately the other end of giant client syndrome, is when you have a single source supplier who provides more than 70% of what you sell. In these circumstances, it is easy for that supplier to control your business.

In both ends of the transaction under giant client syndrome, the only real source of business is that giant client or supplier. Although it is easy for us to leave this be and enjoy what we have while we have it, we will never have an asset to sell or to hand onto our family members who we want to encourage in our footsteps. This poses the question: Do we have a business, or a job? Have we just changed bosses from being a single person to a single corporation? Are we not still a slave to the mill, but just with added responsibilities and no safety net?

Lack of Control

The first and most important stage of overcoming giant client syndrome, is to recognise that you have it. In most cases, a glance at your profit and loss or a dissection of your debtors, will tell you immediately if your source of income is at a critical imbalance. However, sometimes some professional engineering practices, consultancies and contractors, have a number of clients who are individually not representing any majority on their profit and loss, however they have a common contract to a single common client. This still provides a secondary giant client syndrome, with even less control for the business.

It is fair to assume that with international trading, if even a sizeable company has a single contract with an overseas buyer, this overseas buyer may elect to change the rules during the course of the agreement period, regardless of the legal consequences. What may be illegal in Australia, may be quite legal in other jurisdictions. When dealing overseas you must assume that none of your established business protocols are held in any esteem by your suppliers, your clients or your competitors.

There are several options available to the service business with giant client syndrome. The hardest of which is to renegotiate the contract with the single supplier. This will not resolve the problem, but it may give you an extension of more favourable terms, so you can use this time to diversify your business.

Small tenancies and giant client syndrome

Another twist to the giant client syndrome is tenancies, where a small retail organisation is based within a major shopping centre. It has been publicly stated by one of the directors of a major shopping centre chain, that the goodwill component of each store tenant, belongs to the centre. They believe that they bring the people to the shopping centre and therefore they should own the goodwill and subsequently discount that when considering their tenants. As most tenancies in major shopping centres are five years and after 10 years require refurbishment, the only reasonable time to sell a business in a shopping centre, is immediately after the first five year renewal.

Beyond this interval, your tenure as a tenant is reduced and your renewal is never certain and will not be confirmed by shopping centre management. This can mean that if you have traded for 20 years in the same position in a shopping centre, at the end of your fourth five-year lease period, they may choose not to renew your lease and move you out. This is reflected in the "discount for risk" percentage, that any due diligence report done on your business, will pull your price down, in comparison to a similar store on a street frontage or strip mall.

The Consequences

if you have a business which is founded on the premise that your major client or your major supplier represents more than 70% of sales or supply, you have a problem. This problem may not manifest itself immediately, however if you don't take action as soon as you can, you are going to be vulnerable to any decisions made by these parties independent of you.

The most critical impact on your business is at resale. You can't ask a fair and equitable price for the business, if your client base has giant client syndrome. Nobody (with the exception of the giant client themselves) will want to buy the business, because of the vulnerabilities it represents, with that single client. Any due diligence program will discount your goodwill on the basis that your capacity to trade beyond the contract period of that agreement is severely hampered by the winds of change within a procurement team within a major Corporation, that they haven't met and have no influence over.

Notwithstanding a reduced resale value for the business, you may one day find that changes in management of the client, means that your contract tenure is not as secure as you thought was. In some cases, new management just want to make change for the sake of change, as a way of stamping their own style on a corporation. They may have friends and relatives in competition to your business and wish to bring them in as shared or substitute suppliers. In most cases, the major corporations provide for this in their contract agreements, which small companies are forced to sign. However unfair it appears, the practice is not illegal.

I have witnessed cases where giant client syndrome has destroyed a very profitable small business, simply because the giant client was acquired by another corporation, who already had a service agreement in place with the competition. In one case, where we were asked to consult to the client, we had to suggest to the client that the job offer that he was given by the giant client, was probably his best option in the short term. Sadly, a long-term and very profitable business closed its doors that day.

The 5-Step Plan

1. **Damage Control Assessment**

   The first and most important function of giant client syndrome restructure, is to conduct a business diagnostic review. This is to determine what the damage would be, if is client pulled out tomorrow. We have to know what overhead is required and we have to divide personnel to fixed and variable in function, so we know which roles can be made redundant, upon any announcement.

2. **Set a 12-month Vision**

   In most cases, we have to realign the business, so we can re-track back to the same turnover, if the giant client is removed. We have to ensure that our overheads are contained and our margins are not compromised. In most cases, despite the lower volumes, the margins do increase. This is usually because the giant client enjoys a substantial discount over other customers.

3. **Map the strategy**

Once we have consensus on the 12 month vision for the business, we have to design and fund a plan, which will deliver us what we need to separate the profitability of the business, from the giant client contract. This does not mean that we intend to discard the giant client, but ensures that we can reduce their influence over our business, if they represent less than 50% of our business after the 12 month period. Some of the more common options in the strategic planning process, would include:

   a. Diversify (geographically and demographically)
   b. Disclosure
   c. Buying Clients (acquisition of complementary Businesses)
   d. Trade sale of an agreement (if possible)
   e. Multi-channel marketing.

4. **Make the Shift**

This is the fun part of the 10 month program we run under Formula 1 For Business. This features the implementation of a carefully structured plan, of incremental change and constant monitoring. Under our structured program we set out and sequence the incremental changes required to meet the new 12-month mission.

We then establish a project status review process, where we check the progress on the structural change, in real time. This type of distance monitoring and assistance, can greatly reduce for the small businesses that wish to make the transition. In most cases, small businesses and practices of less than $5m annual turnover, may not be able to afford a $600 an hour consultant in the business, on a regular basis. Getting the required assistance remotely, on a monthly basis, for not much more than a few hours consulting time, makes the Formula One for Business program affordable for most and essential for those that recognise their Giant Client Syndrome could be fatal to their business.

5. **Representing the larger You**

Towards the end of the twelve months change interval, with the influence of the giant client reduced to below fifty percent of your revenues, you have a more robust negotiating position for contract variations, renewals and extensions. This is not the time to become aggressive with the giant client. However, one can represent the consultancy or service business to the giant client as a safer proposition for business service provision. In some cases, where we classify the giant client as a potential C class client, we may implement a strategy to raise them to become a B class client.

As part of our business diagnostic review at the beginning of a change interval, we generally classify the current list as As, Bs, Cs, and D-class clients. Our A classification is for advocates, who not only present good business to us on a regular basis, but pay their accounts on time and promote us to other prospect of clients. Our B classification is for quality clients, with most of the attributes above, but may not be advocates for our business. C class clients are the clients that take more work resources, take longer to pay their accounts, or have negotiated less than favourable terms with our sales force. Our D classification is reserved for clients that we would like to exit from our business and in some cases we believe we would be better off if they'll with our competition. We have many strategies to convert D clients to C clients, and C clients to B clients.

One of the more colourful tactics we use is FOP's This is better explained as F**** off pricing. In most cases, a C client can become a B client if trading is done at a more reasonable pricing structure. Our tactic there is simply to increase their price by negotiation, and walk away if they don't agree to our new terms. We generally do FOPs towards the end of 12 month transition interval, so we already have more industry and marketing muscle to reinforce our requirements.

Summary

Of every successful transition interval, we encourage clients to have their business revalued. Having an increasing value in the business that remains profitable throughout the transition, can sometimes still be a surprise to some business owners. Freeing yourself from giant client syndrome is not an easy transition. However, the rewards are many and lasting. They include:

1. suffering less of a risk discount in any due diligence assessment, should you be selling your business.
2. Less call for the services of the principal, by the giant client.
3. Less susceptibility to changes within the giant client business structure and model
4. the reduction of stress associated with caring for every whim of a procurement manager, when contracts are due for renewal.

In most cases, giant client syndrome has been with small consultancies and service businesses since their inception. In some cases the principal does not recognise it as a problem. For those that do I invite you to make contact with Simon or Daniel, at www.formula1forbusiness.com and ask for a 45-minute obligation-free "Check under the hood" conference call, to determine if your business can be freed of giant client syndrome.