

How do management consultants charge for services?

The fee charged by a management consultant should be based on the knowledge and experience of the consultant or consultants to be engaged. The client should assess the size of the fee against the fees charged by other consultants and the reputation of the consultant or consulting firm under consideration. The client should also carefully consider the expected benefit of a successful outcome and the potential costs of a poor outcome.

Consultant fees are normally expressed as an hourly or daily rate. It is generally in the interests of both the client and the consultant to agree a specific brief or terms of engagement for each consulting assignment or each stage of a consulting assignment. A consultant will usually have sufficient knowledge and experience to propose a flat fee for each assignment or each staged package of work. In some circumstances it will be necessary to estimate costs initially.

Payment is normally made according to a schedule based either on specific deliverables or key milestones. The first payment is usually made either at the time of the first deliverable or milestone or on signing of a contract. The last payment is usually made on delivery or acceptance of the final report. Sometimes a consultant performs an initial piece of work to scope a project or to prepare a brief. This may be conducted for a set fee, or at an hourly or daily rate with a fees cap if the scale of the work is unclear.

In cases where a consultant acts as an interim manager fees will generally be at a daily rate for a specific time period which may be extended or curtailed on mutual agreement. A consultant often acts as an independent member of a board of directors, project board, audit committee or on an advisory committee. In these cases it would be typical to have a set fee for each meeting which would cover time at the meeting, travel time and preparation time reading papers etc.

Disbursements such as travel will generally be invoiced separately and expectations about the nature of disbursements to be billed should be clear to both client and consultant at the commencement of an assignment. Expectations about the reasonableness of disbursements can differ significantly from one country to another and from the private to the public sector. Consultants should not make assumptions about which expenses can be charged to a client.

Managers who have not previously used management consultants sometimes make the mistake of regarding a consultant as a temporary employee. This can be reflected in budgeting for use of consultants. For example:

A Government department employs 20 contract managers at a typical salary of \$90,000. The department hears of inefficiencies in contracting practice and decides to bring in a consultant for a month to look into the reports. Since a contract manager is paid \$90,000 per year the organisation budgets \$7,500 to pay for the consultant.

The organisation has expressed the cost of the consultant in terms of the cost of an employee when the reality is that the consultant is providing a specific service quite

different from what is done by the department's employees. The consultant also works for or operates a business with its own cost structures. A consultant is expected to provide the value that comes from independent expertise and to assume the risks that providing independent frank advice entails. This includes the very real risk that the client will not accept the advice (regardless of its accuracy) and will never engage the consultant again.

It may be helpful to examine how fees are derived – not just for consultants but also for independent contractors, who are sometimes considered as an alternative to consultants.

Fees for contractors – executive leases

An independent contractor (executive lessee) is a person with expertise in a given field who has enough confidence in their own ability to offer their services on short term contracts rather than relying on a permanent job. Some contractors are simply filling in time between jobs while others contract as a career choice. Most contractors gain contracts through executive leasing firms, operating mainly in the IT, Finance, HR and Health sectors. These agencies usually calculate hourly and daily rates as below:

There are 365 days in a year with 8 hours in a day making 2920 hours in a year. Once weekends, public holidays, annual leave, sick leave and training days are subtracted the balance is about 220 days or 1760 hours. The actual figure will vary from country to country and among agencies. This is a New Zealand example.

The average salary for a role is divided by 1760 to give an hourly rate. The agency fee of \$12-\$25 per hour is loaded on top. A \$17 agency fee is assumed here. The rate paid to the contractor and the agency's fee will vary with market conditions.

The table below illustrates how this calculation is used:

Typical executive leasing agency calculation (salary/likely working hours per year)

These are the rates charged to the client, not rates paid to contractors

| | | | | | |
|--------------------------|-----------|------------|------------|------------|------------|
| Annual salary equivalent | \$ 80,000 | \$ 100,000 | \$ 125,000 | \$ 150,000 | \$ 175,000 |
| Equivalent hourly rate | \$ 62 | \$ 74 | \$ 88 | \$ 102 | \$ 116 |
| Equivalent daily rate | \$ 500 | \$ 591 | \$ 704 | \$ 818 | \$ 931 |

In order for a contractor to sustain an equivalent income to someone in a permanent role it is necessary to maintain a premium of at least 20% on top of these rates to cover downtime and the costs of attending training courses etc. An inability to do so is a factor that forces many contractors to go back to permanent roles.

In practice there is sometimes a discrepancy between salary and contract rates for the same profession. Such differences may occur because the nature of permanent roles differs from contract roles e.g. the average rate for a contract project manager may equate to a much higher salary than that generally paid for permanent project management roles and this may reflect larger scope or greater uncertainty in contract roles.

Fees for management consultants

Management consultants have a higher cost structure than contractors due to:

- Operating a business rather than just employing themselves;
- Developing and maintaining consulting methodologies;
- High requirements for professional development, maintaining not only skills but knowledge of theory and practice, current affairs, statutory environment etc;
- Liability issues and insurance requirements;
- Maintaining professional accreditation.

An example is provided below as an illustration of how a management consultant might calculate the rate to be charged for services.

Consulting rate based on 50% overhead and 65% billable time target

| | | | | | |
|--------------------------|-----------|------------|------------|------------|------------|
| Annual salary equivalent | \$ 80,000 | \$ 100,000 | \$ 125,000 | \$ 150,000 | \$ 175,000 |
| Equivalent hourly rate | \$ 92 | \$ 115 | \$ 144 | \$ 173 | \$ 202 |
| Equivalent daily rate | \$ 738 | \$ 923 | \$ 1,154 | \$ 1,385 | \$ 1,615 |

This example assumes that the cost of operating the practice will be 50% of gross revenue. It also assumes that 65% of working days (all days except weekends and public holidays) will be able to be billed to clients. The 65% target allows for leave and the time a consultant must spend on professional development, business administration, marketing and networking. Some firms have billable time targets of 75% and the calculation method can vary. The 50% overhead figure needs to include rent, depreciation on business assets, operating expenses, consumables, marketing costs, training and development etc.

This example does not relate to any specific business. It is a simple view of pricing models that are used in the real world. It is, however, indicative of the cost structure of a small to medium consulting business. A sole practitioner operating from home may be able to operate with lower overheads and this may be reflected in rates. A specialist consultancy may have higher overheads. Partners and Directors of large firms will often charge much higher rates based on their knowledge and experience, their previous success or the reputation of their firm. Higher fees often also reflect the higher risk a firm assumes in the assignments it takes on.

A client who views a consultant's rate as directly comparable to an employee would regard a consultant charging \$175 per hour as earning a salary of \$308,000 (\$175 x 1760 as per executive leasing example above). In fact the consultant's salary is about \$152,000, using the example above. A consultant provides a specific service for a specific period of time and the client is paying for that service.

The information in this paper is not intended to provide advice on appropriate fees for specific consultants or services. Clients and consultants should satisfy themselves that any fees charged represent value for money in a specific situation.

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