

Knowing how to set your billing rate is essential to your success as a solo professional.

TWO APPROACHES

Solo professionals have two options when determining how much they will charge for their time. One is the top-down approach; the other is the bottom-up approach.

Top-Down Approach

Top-down refers to a method of analysis that progresses from the general to the specific. For example, imagine that your competitor sells his consulting services for \$100 per hour. A top-down competitive analysis might benchmark your competing service offering at the same price and then attempt to discover how you might provide your service better, cheaper, or more efficiently.

Is there a way that you can improve the service and compete on value delivered? Is there a way that you can cut corners and compete on price? Can you introduce efficiencies in the process that increase your profit margin? What are all of the (specific) elements in the delivery process that you must consider and control to arrive at your (general) market price point?

Bottom-up Approach

Bottom-up, on the other hand, refers to a method of analysis that progresses from the specific to the general. For example, imagine that you are offering an entirely new type of service for which there is no market price point.

To ensure that the price is both attractive to your target market and profitable, you must take into consideration every aspect of the delivery process, including the costs of materials and supplies, marketing, software programs, specialized training, commercial insurance, subcontractors and all the administrative overhead required to support your service offering. You must also decide how much profit (gross earnings) you want to earn at the end of the year. These are the specifics.

Only through careful analysis of the (specific) elements in the consulting process would you be able to arrive at a (general) market price point for your consulting services.

Most solo professionals use some form of top-down approach when setting the price for their services. Nevertheless, to arrive at a price that ensures satisfactory gross earnings after all expenses, you must also consider all of the bottom-up factors (specifics) that affect the ultimate (general) price that you will charge your clients and customers.

TWO TOP-DOWN APPROACHES THAT WORK WELL

Most contract professionals use some form of top-down approach to setting their billing rate. Here is a commonly used top-down approach and one that you may not have considered.

What the Market Will Bear

Two similar concepts are “the going rate” and “what the market will bear.” The going rate is the average value of your skill set in the current marketplace. This value changes over time according to the law of supply and demand as buyers and sellers negotiate prices. Sellers set their prices and buyers either buy or pass. The resulting price is what the market will bear.

It is through the process of negotiation that the going rate moves up or down according to what the market will bear.

You should always go into contract negotiations with a rate that you believe is a little higher than the going market rate and see if the client pushes back. If the client does not push back on your billing rate, it may mean that you are leaving money on the table, and you will probably want to initiate negotiations with your next client at a higher billing rate.

The psychology behind this approach is interesting. Let’s say that you bump your rate by 10% and, instead of charging \$100 per hour, you charge \$110.

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If the client pushes back, you might agree to drop your rate by \$5 to secure the contract. You have now increased your earnings by 5%. You are happy that you are making more money and the client is happy because, from his perspective, he got a deal.

Because the going rate is an average, there will always be providers who charge less and others who consistently charge more. By successfully charging more for your services, you establish your higher value in the marketplace, making it easier for you to charge even higher rates in the future. By selling on the basis of value delivered instead of low price, you now have the opportunity to validate that old adage, "The customer always gets what he pays for," by exceeding the customer's expectations.

How do you find the going market rate? Do a competitive market analysis of the rates charged by members of your profession. Search the Internet for rate surveys. Check out company career pages. Ask fellow service providers. Over time, your own experience at negotiating rates with clients will tell you exactly what your services are worth.

Divide-by-1000 Rule of Thumb

Search the Internet for salary surveys. Check out company career pages or ask the HR department at a prospective client to quote a salary range for a position that utilizes your skills and experience. The idea is to learn what a full-time, salaried, fully benefited, regular employee with similar skills and experience earns over the course of a year. Divide the annual salary by 1000 to arrive at an hourly billing rate that, over the course of a year, will generate an equivalent gross wage.

Studies of salary surveys and billing rate surveys validate the universal accuracy of this top-down algorithm. The section, *Calculating the Billing Rate*, below, explains why the divide-by-1000 rule of thumb works so well as an algorithm for converting salaries to equivalent billing rates.

TWO TOP-DOWN APPROACHES THAT DO NOT WORK

Following is a brief discussion of two, all-too-common, top-down approaches that contract professionals should avoid.

Rollover

A rollover occurs when a contractor "rolls over" and agrees to work for whatever rate the client states. Don't do it. Have you ever heard a seller ask a customer, "How little do you want me to charge you for the work I am going to do for you?" Letting the buyer set your rate is a common rookie mistake. Rolling over puts control of the billing rate in the hands of the client and undermines the value of your work. Professional service providers set the price of their services. The role of the customer is to accept the price, attempt to negotiate a lower price, or walk away from the deal.

Lowball

A lowball occurs when the contractor competes solely on the basis of low price. Lowballing is profoundly unprofessional. It turns contract work into a commodity and undermines your standing as a professional.

The practice of lowballing is insulting to clients who know that they invariably get what they pay for. Compete on the basis of value, not price. Create high expectations and then exceed them.

YOUR BILLING RATE IS THE LOADED LABOR COST

The Loaded Labor Cost

The billing rate of a solo professional is equivalent to the fully loaded labor cost of an equally skilled and equally experienced regular employee divided by the number of hours the solo professional expects to work during the year.

The loaded labor cost of an employee is the employee's annual salary PLUS all of the overhead costs that are required to support the employee, including the employer's share of payroll taxes, employee benefits, facilities, equipment, supplies, training, and administration. The labor load in a large company can range from 50% to 100% above an employee's annual salary.

Large companies have the buying power to make all of their purchases at deeply discounted rates. Unfortunately, solo professionals must pay full retail for almost everything they purchase. For this reason, the loaded labor cost for a self-employed person can be significantly higher than the loaded labor cost for the employee of a large company.

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Billable vs. Non-billable Hours

Although there are 2080 hours in a 52-week work-year, most self-employed persons perform billable work only 42 weeks, or 1680 hours, over the course of a year. The remaining 10 weeks represent non-billable downtime for national holidays, vacation time, sick time, training time, self-marketing time and unavoidable downtime between customers and clients.

Most salaried employees also work only 42 weeks over the course of a year. However, they are usually paid for their non-productive downtime. Self-employed persons are paid only for the time they can actually bill their customers.

Calculating the Billing Rate

If I were the CFO of an organization, how would I know if I was paying too much for the services of an outside vendor of consulting services? I might follow the following steps to benchmark the billing rate against the salary of an equivalently skilled employee:

1. Take the salary of an equivalently skilled employee.
2. Compute the loaded labor cost for that employee.
3. Divide by the number of hours an employee (or consultant) works during the year.

By comparing the billing rate of an outside consultant in this way, I can decide whether I am paying too much for the consultant, or determine if I should hire an employee instead.

Let's set the loaded labor cost at 1.7 times the annual salary and assume there are 1700 productive hours in a work-year. The target billing rate will be:

$$\begin{aligned} \text{Target Billing Rate} &= \\ \text{Annual Salary} * 1.7 / 1700 \text{ hours} &= \\ \text{Annual Salary} / 1000 & \end{aligned}$$

Different assumptions will lead to different results, and your mileage may vary, but, overall, the Divide-by-1000 Rule of Thumb works very well in most situations.

Let's say that you are a technical writer, and you know from researching on-line salary surveys that a full-time, fully benefited, salaried technical writer with your particular skill set should earn \$75,000 per year.

Knowing this, you would not accept less than \$75 per hour to work as a consulting technical writer, and a corporate CFO would not pay more than \$75 having benchmarked the target billing rate against the loaded labor cost of an equivalently skilled employee.

The tension between these two points of view is what makes contract negotiation so interesting.

Billing by the Project or Milestone

If you bill by the project or milestone, you will estimate the duration of the project and submit a bid for the number of hours required to complete the project. If your bid includes materials, then you will add the cost of materials plus a reasonable retail mark-up to the total cost of your proposal.

ABOUT SOLO W-2, INC.

Solo W-2, Inc. began in 1998 as an economical and benefits-rich alternative to the traditional staffing vendor business model.

Solo W-2, Inc. provides back-office logistics support, executive-level employee benefits and contracts administration for independent professionals, including self-employed persons, small business owners, freelancers and consultants.

Solo W-2, Inc. also provides contingent workforce compliance, co-employment risk mitigation and contractor payment services for corporate employers, progressive staffing vendors and government agencies.

Solo W-2, Inc. serves independent professionals and client companies throughout the United States from its corporate offices located at:

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