CALCULATING A FEE RATE

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I have read a large number of articles telling me how I should calculate my fee rate, and have seen computer programmes that claim to do it. First add up all your office expenses and overheads, then add in your desired salary before tax to get the total revenue required. Divide this by the number of days you wish to work, and you have the daily rate you must charge.

Unfortunately, this gives the wrong result, so wrong that one must ask what sort of advice consultants give their clients on pricing. Calculating your fees in this way may mean that you charge such high fees that you get very little work and very little income. Alternatively, it may mean that you are charging fees well below what the market will bear, and are working 365 days a year for a low income. This method does not even pretend to work out the optimum fee.

In Table 1 I have drawn up a schedule showing how fees might affect days worked, using invented figures for simplicity. I start with a consultant who spends all the time he is not working sitting in his garden watching the flowers grow (Column b). At a fee rate of £100 a day he works only 50 days a year, because nobody trusts a consultant who charges so little (though there are always eccentric clients who try to beat you down). At £300 a day, he works the longest, 260 days a year, and as the rate rises the number of days worked falls steadily. The maximum total revenue does not come when he works most days, but when he charges rather more, £400 a day instead of £500 (Column c). As the fee rate rises beyond this, total revenue falls. This is shown as the bottom curve in Figure 1.

FEE RATE AND TOTAL REVENUE, WITH AND WITHOUT MARKETING AND CPD

Fee Rate	No Marketing or Devt		Marketing only		Marketing and Devt Short Run		Marketing and Devt Long run	
£	Days Employed	Total Revenue	Days Employed	Total Revenue	Days Employed	Total Revenue	Days Employed	Total Revenue
100	50	5000	113	11300	82	8200	160	16000
200	150	30000	193	38600	172	34400	225	45000
300	260	78000	281	84300	271	81300	297	89100
400	210	84000	241	96400	226	90400	264	105600
500	160	80000	201	100500	181	90500	232	116000
600	110	66000	161	96600	136	81600	199	119400
700	60	42000	121	84700	91	63700	167	116900
800	30	24000	97	77600	64	51200	147	117600
900	10	9000	81	72900	46	41400	134	120600
1000	5	5000	77	77000	41	41000	131	131000

In this example, the consultant gets the maximum income when he works only 200 to 210 days a year. If he charged only £300 a day, he would work two months a year longer, and get £6000 a year <u>less</u>. A consultant who really enjoys his leisure might charge £600 a day and work only 110 days a year.

Most consultants, though, have something of the workaholic in them, and they do not enjoy sitting idle. There is also the constant worry that, while there are plenty of jobs today, there may not be next year. Some consultants will use any time they are not on a job selling their services. This is shown in Column d. It is assumed here that it takes four to five days marketing to sell an additional day's consultancy at the same fee rate. For example, instead of a consultant working 50 days a year and doing nothing the rest of the year, he spends the rest of the time selling his services and brings up his paid time to 110 days. These figures are quite arbitrary, of course - no two consultants get the same payoff from marketing and four days marketing does not bring in the same extra work at £100 and £1000 a day.

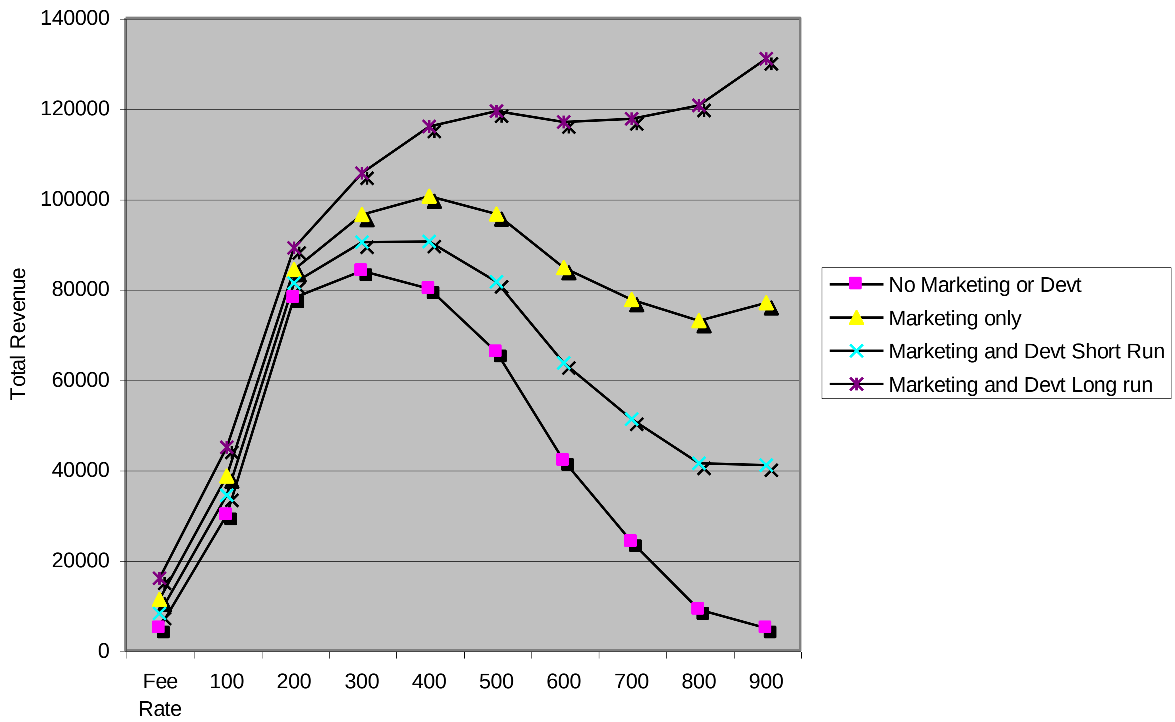
In this example, the maximum income is achieved by charging a higher fee than before, £500, and using the spare time to sell his services. This is shown in Columns d and e of Table 1 and in the second curve from the top in Figure 1.

A formal economic model of this is somewhat more complicated than this simplified example suggests, with the relationship between fees, marketing activity and days worked presented as a three dimensional model, with different response to marketing at each level of fees.

A consultant who spends all his time on paid work and marketing his services gets stale; his professional knowledge gets out of date and he becomes narrow. His clients start to move away. How serious this varies from specialism to specialism. In my own area, marketing economics, I can say that anyone who does not spend a month a year keeping up with the literature will lose his skills, and that two months a year are needed to more or less keep up with the new developments. If you are going to have any pretensions at being a leader in the subject, you have to develop new theory and publish it, not just read what others have said, and this takes time.

This means that the response to fee rates and marketing in Columns a, b, c, d and e are <u>short term only</u>. The revenue will fall over time as the consultant's knowledge gets obsolete.

To survive in the long run, a consultant must spend some time in developing his personal skills. This means a reduced income in the short run, as he cannot spend so long marketing his services. This is shown in Columns f and g which give the short run payoff from reducing marketing. The total revenue curve lies somewhere between that of the zero marketing and the full marketing option.



The longrun payoff is higher than the full marketing option. With the figures used here, it has the effect of doubling the optimum fee rates.

Any consultant can improve his pricing policy by trying to work out the response to increased fees in this way. Even if there is no other benefit from the exercise, your marketing will improve as you work out who your potential clients are, and how they choose a consultant. Obviously, the larger consultancy firms have more opportunity to experiment with fee rates and work out which is the optimum rate.

It would be very dangerous to generalize from a simplified model and arbitrary figures, but the possibility should be considered that many consultants are undercharging, working too long, and not spending enough time on personal development.