

# Becoming An Independent Consultant

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## Abstract

*You've been working for a large company or consulting firm for years, you're restless, and thoughts of going out on your own fill your mind. This dream has come true for many in the past. But many who try either fail or are disappointed. How best to do it, what can you expect, how to avoid potential pitfalls? All these questions and more are the focus of this article, written by a successful management consultant who went independent. Until he retired, the author was a Certified Management Consultant (CMC) awarded by the Institute of Management Consultants.*

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## Making The Decision

You find yourself dreaming of working for yourself. You're tired of bosses, structure, rigid hours, commuting etc. Management consulting sounds like a good way to make this dream come true. Yet there are many things to consider that, properly investigated, may make you change your mind. Conversely, your research may increase your resolve to go out on your own.

A first fundamental decision is to be very introspective and decide whether you can really tolerate being on your own with the sharp decrease in the collegiality that is a normal part of every large firm. To succeed on your own you will need to:

- Substitute phone contact for the direct relationships in an office
- Develop even more self discipline and management of your time and projects
- Learn more about the administration and financial management that you may have taken for granted in the large firm
- Have patience in closing new clients—and the financial resources to be able to afford such patience
- Have a sharply focused marketing strategy based on carefully considered positioning of your practice to differentiate yourself in an increasingly crowded consulting market place.
- Learn to type (if you are not already competent) and operate office equipment and computers with comfort.
- Maintain the scrupulous ethics and honesty that are the hallmark of any successful consultant—and to pay even more attention to the perception of ethical behavior.

These are just a few of the topics you will have to address if you are to succeed on your own. It takes time to build up a practice unless you are fortunate to be in a position to ethically bring old clients with you. You should be

mentally prepared to go as much as six months without a client and should have sufficient resources to handle this without discomfort. This can be "white knuckle" time, but patience and persistence will usually win the day if you have positioned yourself and your new practice effectively.

## Positioning Your Practice

Competitive differentiation is the most important key to success. There are many consultants and consulting firms with more emerging all the time. The good news is that consultants may be in even greater demand as companies continue to downsize and outsource.

Positioning is a marketing term. It involves developing a strategy that clearly explains what you will do to get customers to buy from you at the expense of competitors.

Al Ries and Jack Trout, well known marketing experts,<sup>1</sup> describe positioning as:

- what you do to the prospect's mind to condition how he/she thinks about your consulting services.
- what you do to "get heard."
- how you cope with the mental position that a larger, more established competitor occupies.
- how to cope with information overload (and anxiety) among your target prospects.
- how to be consistent – to hang in there year after year if your positioning seems effective.
- how to manipulate what's already in the mind – to retie connections that already exist.

Positioning is the process of developing a marketing "message" so that your total offering is clear to your customers and is effectively differentiated from those of your competitors. Start by asking yourself questions like these:

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<sup>1</sup> Positioning: The Battle For Your Mind, Al Ries & Jack Trout, McGraw Hill, 1986

- How do I want my consulting services perceived by which parts of the market place?
- What specific benefits do I want to highlight?
- What themes should I stress in my marketing communications and events?

The positioning statement is a checklist against which all communications are created and evaluated. Developing your core positioning strategy is a creative and dynamic process, calling for constant evaluation and revision

### Your Positioning Strategy

To develop a positioning strategy start by identifying your unique experiences and skills – your competitive advantages. What have you done that has unusual value to potential clients – and which you can communicate effectively? You should strive to select advantages that give you an unusual position of competence – hopefully one that might be perceived as not easily available elsewhere.

When you are done with your initial efforts, be sure to test them out on friendly clients. **Note:** if you are not satisfied with your positioning efforts, and cannot get clients to react favorably, then you might want to reconsider your decision to go out on your own until you and your potential clients are satisfied. You want to be absolutely sure you are working on the right things.

In developing your positioning, you may want to limit your practice to certain types and/or sizes of clients. Some consultants focus on specific industries, some on small companies, and some on special geographic areas.

Another differentiation strategy is to go in the opposite direction. Provide a commodity service on an outsourced basis to clients who have downsized or are considering farming out part or all of a basic support service. This can be especially effective if your consulting experience is more limited and you have had a substantial corporate career in one or more vital support services. In this case your differentiation strategy may offer convenience, flexibility and cost control to a few steady clients.

The most common positioning strategy, and the most rewarding, is to limit your practice narrowly in a specialty that is in good demand and perceived as having few practitioners (easy to say, tough to do).

### Where Will You Locate

Many independent consultants work effectively out of their homes. To do this you need a pleasant, dedicated room (for tax purposes if nothing else)—preferably with windows and a view. You will be spending a lot of time there, so be comfortable. A pleasant work space can make a big difference in your staying power—especially at first.

If you feel you must have an outside office, then investigate an office condo or shared space kind of arrangement. Ask your lawyer or small business friend if there is a spare office you can rent. This may also offer you the choice of sharing office support services inexpensively. Avoid renting a conventional office. This will be a big cash drain on your funds.

### Setting Up Your Office

Communications are the life blood of a consulting practice. Start with two and possibly three dedicated telephone lines. Two will be for voice calls and the third for the fax machine. If you prefer only one voice line, then be sure you have “call waiting” service available to you. However, use the fax line for many of your own outgoing phone calls to minimize the often annoying “call waiting” signals.

You will need a desk, comfortable desk chair, bookcases or shelves and probably twice as many file cabinets as you can imagine you will ever need. Lateral files are the roomiest and most space efficient. Large office discount chains are excellent sources for such furnishings at reasonable prices.

Modern computing and telecommunications technology are fundamentally what make the home office possible. While you don’t need bells and whistles, I have learned the hard way that there are certain types of equipment where it doesn’t pay to stint.

**Telephones** Get a quality phone with speed dialing and either a built-in answering machine or separate unit. Brands like AT&T, Panasonic and Sony are excellent and very reliable. If you have two voice lines, then you will want a two line phone. AT&T makes excellent all digital answering machines that are both reliable and flexible.

**Copying Machine** A wide range of copiers are suitable for home office use. I recommend Canon because they are extremely reliable. All critical parts are replaced when the toner cartridge is replaced. And many models have several steps of image reduction and expansion. I have yet to meet a dissatisfied owner.

**Fax Machine** Get a plain paper fax machine. Consider fax machines made by Hewlett Packard, Canon or Brother. They cost \$200 or less.

Don’t be tempted to get a combo fax/printer unless you are very short on money. While they are adequate fax machines, they are slow printers and complex to use. And the ink cartridges are expensive. However, there are laser combo machines now available with lower operating costs and higher quality (but no color).

**The Computer** Obviously, your computer is the nerve center of your office. If you are very experienced with Windows based computers, then stick with that. Dell, HP or Gateway are reasonably priced and have good technical support.

If you are a computer novice, then consider Macintosh. At the risk of stirring up controversy, Macintosh computers seem to be the choice for anyone relatively new to computing. You can be up and running with them almost immediately and, once you learn one software program, others are much easier thanks to Apple's standard user interface guidelines for software developers. They also make desktop publishing and graphics easier—a real boon for the independent consultant. And almost any standard document from a Macintosh can be read by a PC (or vice versa).

The Macintosh G5 Power Macs are excellent value and readily upgradeable. Get it with at least 512 meg of RAM, preferably more. RAM is cheap. Apple's eMacs or iMacs are also excellent "all in one" units. The new Macs now can run both Windows XP and the Mac Operating system so you have the best of both worlds.

If you feel you want a Windows based computer, focus on Dell or Gateway as they seem to have the best technical support.

Regardless of which model you buy, be prepared to have it seem "old fashioned" within no more than 18 months. It won't actually be outmoded, but if you read computer magazines (recommended), then you may feel like it is.

Plan on spending \$2,000 to \$2,500 including the monitor and printer. Get at least a 17" monitor. LCD flat screen monitors take up less space and are very sharp. Dell Ultra Sharp LCD monitors are reasonably priced and top rated. They will work with either Windows or Macs.

You will also want back-up equipment to protect your vital computer files. Common choices include Iomega ZIP Drives with disks that hold 100-250 meg of files. You can also burn CD's a back up means but this takes more time than ZIP disks. Try to keep your back up files in a separate place. Some recommend keeping the removable disk in a safe deposit box. Others buy a media-safe fire proof storage box and keep it in the basement. External hard drives are also great for back up and are very cost effective and fast.

Whatever you do, always back up at least weekly or immediately after you have created any important document. Rest assured that it is not IF you lose data from a disk crash, but WHEN! I back up at the end of every day and usually after every document has been completed.

Finally, for each computer, buy an uninterruptible power supply (UPS). If you don't, then you surely will the very first time you lose an important document because of a sudden power outage, however momentary. UPS devices cost as little as \$100 and give you 10 to 20 minutes to save what you are working on and go through an orderly shutdown of the computer. APC is a reliable manufacturer and readily available.

**Software** Get Microsoft Office. This package is priced at around \$400 and is readily available by mail order (try PC/Mac Connection, or Mac/PC Mall) MS Office contains MS Word (word processing), Excel (spread sheet) and PowerPoint (presentations). A student in the house? Get the Student Edition for \$140. You will also want Quicken (\$60) (for your business accounting). You will also want software such as:

<u>Norton Utilities (PC &amp; Mac)</u> <u>Disk Warrior (Mac)</u>	Fixes things that can go wrong with your disks and hard drive
<u>Palm Desktop</u>	Usually a free download that works great even if you don't have the Palm Hand-held Organizer.
<u>Norton Internet Security</u>	A firewall and updated antivirus program

**Printers** Hewlett Packard, Brother and Lexmark make excellent laser printers. They offer 600+ DPI resolution and should be considered if you are going to be printing masters for newsletters and similar items. Plan on spending between \$350 and \$900. If your printing volume is low, you want to save money on the printer or you need color printing, buy an ink jet printer from Hewlett Packard or Epson (\$100-\$250) But the cost per page will be high due to expensive ink cartridges. If you do a lot of color printing, then color laser printers from HP are available for about \$600 and up..

### So You Find You're Lonely

A drawback to being an independent consultant is the absence of colleagues in the next office. But there are substitutes. Here are some suggestions:

- Schedule informal lunches several times a week
- Join a health club—and use it regularly
- Plan an errand or library visit for each day to get out of the office
- Schedule business development phone calls for a certain time each day
- Join a service club such as Rotary or Lions

Most important, develop a network of independent consulting colleagues that you can trust and talk with. The local chapter of The Institute of Management Consultants is one obvious source. However you do it, this is one of the more important things you should be doing, not only for the collegiality, but also to have a source of people you can subcontract work to—or who can subcontract to you—when business is heavy or when the nature of the engagement demands more than one person.

### Developing Associates

Building relationships with other independent consultants can be hard. Consultants tend to be jealous of client relationships. You have to work hard at being subordinate to them in their clients and they, in turn, have to be able to behave in a like manner in your clients. If both parties

err in the conservative direction, sooner or later, you will develop a number of independent associates who can work together comfortably. This is as much a matter of personal chemistry as it is ethics and being conspicuously fair with each other.

### **Contractual Relationships With Associates**

You do not ordinarily need a lawyer as these are mostly simple letters of understanding as to what your mutual obligations are, subject to modification for specific engagements.

You can compensate each other in one of two ways. One is to simply agree on a per diem or per hour rate. Then for each project agree via a detailed task plan how many hours or days each will get.

The second way is to focus less on the hours and more on how to split the total engagement fees based on roles with the client. An associate of mine has worked out a general system in which there is a commission of, say, 10% for selling the engagement, another 10% for managing the client and then dividing the remaining fees in proportion to the estimated hours each is to work on the project. If there is proprietary technology used in the engagement, its owner may also get a percent off the top. With an agreement in place, you stop counting hours and focus on delighting the client. You may also want a simple confidentiality agreement between the parties. This is especially important if one party has proprietary technology.

If you are doing the invoicing, you should pay your associates their share immediately upon receipt of funds.

### **Managing The Finances**

You are well advised to maintain meticulous financial records. Otherwise you may face a constant stream of IRS penalties. Such record keeping need not be onerous. A computer software package, Quicken, is inexpensive, easy to use and remarkably complete. It is available in either Macintosh or Windows versions and no independent consultant should be without it. Hiring a bookkeeper or accountant to maintain records will save you little time and just cost you money.

Estimating taxes is a big headache. The timing of a consultant's income is erratic and unpredictable. You must not only pay the IRS at least 90% of your owed taxes, but such payment has to be timely relative to when you earn the income. A spreadsheet template to track expected income and expenses can be very useful.

When your income becomes substantial, you will want to consider the retirement funding plans for the self-employed. While the SEP's and Keoghs are well known and may be suitable for most, if you have years when your net income significantly exceeds \$100,000, then another plan is worth setting up, a Defined Benefit Pension Plan. It is especially useful if you anticipate

retirement in ten years or less. Under these plans you can shelter from current taxes as much as 40% to 50% of your business income

To realize those tax savings, you have to put large amounts of money into your pension plan. This may present a cash flow challenge. And expect around \$1,200 in set-up fees plus from \$500 to \$900 annually in administrative and actuarial fees (all tax deductible). Fidelity Investments offers good defined benefit plans and a wealth of investment choices for your retirement funds. Most large cities also have pension service companies that can do the work for you with a greater variety of customized plans. Finally, new types of IRA's and SEP's have become available that may be better suited to your financial situation. Contact a reliable company such as Fidelity or Vanguard for advice.

Be careful of the relationship with your alliance associates. If you are their sole source of business, their status as independent contractors may come into question with the IRS and you may become responsible for such things as withholding and FICA.

You will need to obtain from the IRS a tax identification number different from your Social Security number. This tax ID # should be tied to the name of your consulting firm. Then put that number on all invoices to clients. Be sure to have a separate checking account and even get a separate credit card for your business expenses. Get a Tax ID number from [www.irs.gov](http://www.irs.gov) and downloading Form SS-4.

There are many other tax issues for the independent consultant which are beyond the scope of this article. A good working relationship with a talented tax accountant can be invaluable..

### **Setting Your Fees**

It may be tempting to start out with low fees in order to speed up client acquisition. But this can be counterproductive. Ironically, larger companies can tend not to take the low priced consultant seriously or to value their actual or potential contributions as much.

Consulting fees range from a low of \$1,200 per day (such as for computer system consulting) to \$5,000 per day. It depends on the nature of your consulting practice, what competition charges, and the size and nature of the prospective client organizations. If you are targeting very specific market segments, and these are dominated by small companies or non-profits, you may have to be at the lower end of the fee range. They won't be used to consulting fees and so will have no real benchmarks to judge the fairness of fees.

As a general guideline, price yourself around 10% to 20% less than those fees charged by large established competitive consulting firms for similar work for similar types of clients. As an independent you can afford to use price as a competitive advantage but going too low can be

bad for your image, not to mention your income. As mentioned above, for some clients, the more you charge, the more they value your work. Price can be an effective part of your market positioning described earlier in this article.

Try to avoid quoting a specific per diem rate. Estimate as accurately as you can in advance—then quote a fixed price for the project. If you are specifically asked for a per diem rate, then always quote the same, high per diem rate.

However, if you feel the project cost is too high for the client at your normal rates, you can quote a total fee for the project based on less time than you actually anticipate spending. The risk in doing this is that you may inadvertently lock yourself into the discounted rate on similar jobs for the same or similar clients. Assess the situation very carefully in advance to be sure you are prepared to accept such discounts on an on-going basis should circumstances dictate.

An advantage of being an independent consultant is that you can also over deliver in the interests of client delight. My colleagues and I do the best job of estimating an engagement we can, often including an extra margin for value added when appropriate. Then when the engagement starts, we stop counting hours and focus on delivering our best work.

## **BUSINESS ORGANIZATION**

One of the most asked questions by the prospective management consultant is “Should I Incorporate?” Your decision will be based primarily on the nature of your practice and your liability exposure. However, most independent management consultants will organize themselves as a:

### **Sole Proprietorship**

This is the most popular form of small business and, as the name implies, ownership is totally vested with one person. It is the easiest to establish since no legal formalities are necessary.

You can use your regular SS# as a tax ID#. However, if you want to set up a Keogh or SEP retirement account, then you will need a separate tax # which you can get from the IRS by filling out and sending in IRS Form SS-4. But you can do that later when you are making enough money to consider putting money aside for a pension.

Sole Proprietorship Advantages:

- Easy and quick and usually the least expensive to establish. In fact, you can just "do it" with no real paper work to fill out at all.
- You have total ownership and control of the business.
- All the profits of the business belong to you.
- No additional Federal taxation on business profits (No double taxation).
- No periodic business reporting to the IRS or other government agency is required.

- Income tax filing is simply part of your annual personal tax return (Form 1040-Schedule C).

Schedule C is great because it has so many deductions on it. And it is not difficult to fill out.

The home office deduction can be a bit tricky to calculate. Fortunately, the IRS has relaxed their rules on this deduction. Get IRS Publication 587. It has explanations for Schedule C and much other useful information.

Sole Proprietorship Disadvantages:

- The owner is personally liable for all business debts and the liability is not limited to the value of the business. You are personally liable for any and all business debt you incur.
- It is generally more difficult to borrow money or obtain outside investment than with other types of legal structures.
- If the owner is incapacitated for any reason, the business is likely to fail.
- All management responsibility is with the owner which can be a heavy burden.

### **Limited Liability Corporation (LLC)**

This type of corporation blends the tax advantages of a partnership and the limited liability advantages of a corporation. Owners of an LLC are referred to as "members." As you might expect, it also has some limitations but is definitely worth considering. Ask about the LLC when you contact your appropriate state office for incorporation information as suggested earlier in the chapter.

LLC Advantages:

- Limited personal liability for the owners (like a corporation and unlike a partnership).
- No Federal taxes (like a partnership).
- No limit on the number of stockholders (unlike an S-corporation).
- More than one class of stock is permitted (unlike an S-corporation).
- Business losses may be deducted on your personal tax return (like a S-corporation).

LLC Disadvantages:

- No "continuity of life" as in a regular corporation. The LLC dissolves if one of the owners dies or otherwise leaves. However, other formal agreements between the owners can overcome this.
- Some states require that an LLC have more than one member.

### **How Does One Set Up a Limited Liability Corp?**

You can form a limited liability company yourself by reading a book or articles available from [www.nolo.com](http://www.nolo.com) and obtaining the necessary forms from the Secretary of State of the state in which you want to form the LLC. However, LLC's are a new form of legal organization and vary from state to state. So you may want to use a local lawyer who promises that he KNOWS LLC's for the state and EXACTLY what is required.

## **Making the Decision**

If there is the faintest doubt in your mind, consult a lawyer and/or your accountant. It will be money well spent.

## **Other Legal, Insurance and Contractual Issues**

Regardless of the type of legal organization, every consultant should have a reasonable level of commercial insurance regardless of his practice—the usual professional and personal liability plus the need to insure your office equipment and records against loss. Policies are generally available at around \$500 annually. While you may have put your home office equipment under your home owners policy, even the minimum commercial policy gives you better office equipment coverage at no additional charge.

Depending on the nature of your practice, you may also need “errors and omissions” insurance as part of the total policy. These types of policies are more expensive.

Consider carefully the purchase of disability insurance. This can be even more important than life insurance and may be something you have taken for granted working for a large employer. But if you are even temporarily disabled, you may experience significant financial hardship. It is human nature to think of yourself as “bullet proof” or that such disasters won’t happen. Don’t fall into that trap. A good disability policy offering around \$5,000 tax free dollars a month after a 90 day waiting period will cost around \$3,000 per year for someone in their mid 50’s. Massachusetts Mutual Life Insurance Company has good policies at very competitive rates. But investigate other companies too.

With client proposals, do the same careful job as required by the large consulting firms. A clear list of deliverables and the basis of fees and invoicing is a must. You will also want to protect your proprietary technology in the proposal, and put a copyright mark © on all of your written consulting tools, training materials and forms.

## **Marketing Plan**

Systematic marketing efforts are a must. Devote at least 25% of your time to them even during engagements. Successful techniques include:

- Personal letters in which you regularly send a clipping or book review to a list of 20 to 30 prospects on a regular basis
- Personal contacts and referrals from satisfied clients at the end of each successful engagement. Many consultants make it a practice to ask for a testimonial letter from the happy client. Some even draft the letter for the client to send back.
- Speeches, if you can arrange them, are invaluable. But you have to be good. Fortunately, with adequate preparation and practice, most consultants can be effective.

- Seminars and workshops, either public or company specific can be as effective as speeches. Many companies look for educational and awareness-building seminars on timely topics for employees.
- Articles are useful, not only to develop direct leads, but also as mailing pieces.
- If you have the material, a newsletter can be a good marketing tool, and a money maker in itself. But be warned—you must publish on a regular schedule and this can be a burden for the sole practitioner.
- Marketing brochures can be useful, but can also be a waste of money. They are difficult to get right and always seem to be evolving. You may want to print logo and address on a presentation folder and then use two color, high quality blank paper to run off a small number of inserts from your own computer. This is inexpensive, attractive and gives you the flexibility of tailoring your communications to the individual client.
- Consider having an Internet web site. It is very inexpensive and, done right, can be effective. It can be used for direct e-mail and to give your prospects access to all your information and brochures. But get a good website designer to set it up right. You can register your domain (website name) at [www.register.com](http://www.register.com), They also have relatively inexpensive website hosting plans, You will also have to promote your site so people will know where it is. Print the website address on all your printed materials including letterhead, business cards, brochures, article reprints etc.

Other Reliable Low Cost Website Hosting And Related Services at as little as \$5 per month include:

[www.icdsoft.com/hosting](http://www.icdsoft.com/hosting)  
[www.racknebula.com](http://www.racknebula.com)

Check Google for more such services

- Finally, consider joining the Institute of Management Consultants and subscribing to the Journal of Management Consulting. There are many local chapters that meet monthly for dinner and networking. See their website: [www.imcusa.org](http://www.imcusa.org)

## **CONCLUSION**

Going out on your own can be very rewarding. In these times of rapid change and low employment security, it can also be the best thing to do if you have the staying power and marketable skills and experience to offer.