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Rate Setting and Insurance: Double Trouble for Consultants?

Pamela Walaski, CSP, CHMM

Introduction

The transition from technical expert to external consultant is one that many in our profession attempt each year for a variety of reasons, such as being downsized, a desire to control one's schedule, and early retirement, among others. And every year many end their practices, often because they are unable to make enough money to survive. The transition can be difficult or smooth, depending upon the personality of the professional, their level of expertise, their ability to use their network and contacts to identify potential clients, and their ability to identify resources to help them. Two questions that tend to be predominate in the early going among those striking out on their own include, "How much do I charge?" and, "Do I need insurance?"

The former question encompasses the age-old dilemma of charging enough to keep from leaving money on the table but not so much that the fees chase business away or send it to another consultant. Even though most consultants intuitively know that they won't be successful with every proposal, staying in business means being "successful enough." In answer to the rate-setting question, there are probably as many pricing strategies employed by consultants as there are consultants. This paper will attempt to provide some tools for approaching the process of quoting a price to a potential client. Ultimately, the one(s) selected is a very individualized process.

The latter question about insurance is also one that creates a lot of discussion among those considering consulting or just entering the field. Most seasoned consultants understand the necessity of it, even if they didn't when they began their practice. However, what type of coverage is necessary and how much to buy are typical questions that most consultants ask, and this paper will also attempt to provide a general framework for addressing them.

Pricing Strategies

Pricing strategies must take into account numerous factors, the exact combination of which is unique to each consultant and/or practice (Roy 2012). They include:

- ***Expertise***. This includes a number of subfactors, including direct professional experience, relevant education, and certifications. On the low end are those consultants providing what is often termed "commodity services:" basic consultation services such as standardized annual training. These are services that require limited expertise and, by extension, command the lowest rates. Many companies utilize this type of consultant, sometimes because they prefer to limit the amount of time their in-house staff devotes to these types of tasks or because company is small, without a dedicated SH&E staff person, and needs some extra help with the basic requirements, among others. Obviously, on the other end are highly specialized consultants who truly have a niche specialty due to exceptional amounts of experience and expertise.

- ***Geographic area***: Navigating this factor requires a strong knowledge of the variations in cost of living, not only in the area where the consultant is practicing but in other areas, so that an understanding of how extensive the range is within the types of services they intend to provide is developed.
- ***Competition:*** It is reasonable to expect that competition would suppress rates, particularly for commodity services in geographical areas; however, consultants with specific niches or significant levels of expertise are often exempt from this factor, simply because there is limited competition for the work that they do.
- ***Positions within the practice:*** For practices with multiple consultants, clients expect a range of rates based upon level of expertise; the larger the practice, the more variation in rates is expected.
- ***Loss leaders:*** This term may be more familiar to those who understand retail pricing; however, it also applies to consultants who are trying to develop new clients or introduce new services to existing clients. The risk to this strategy is that the client may not clearly understand the reason for the "discount" price and may not wish to pay the real price when future services are proposed. The analogy is that many retail shoppers are resistant to buying items not on sale or from discount stores like Target or Wal-Mart once they pay the lower price originally.

There are, of course, numerous methods used by consultants to price their work, and space does not permit a complete discussion here. However, a few of the more common will be addressed, along with the pros and cons, including cost-based, value-based, multiplier, overhead rate, and competitive fee schedule (Roy 2012).

The *competitive fee* schedule remains the simplest method and, in the experience of this author, is the one that most consultants choose early on. The fee schedule is developed by simply taking a survey of what competitors are charging and basing the rates to be charged somewhere in that range. The obvious advantage of this method is that a consultant can be reasonably sure that their rates are "in the ballpark," so to speak, especially in the early going when the learning curve on pricing is steep. The downside to this method is that the survey has to be accurate and, often, consultants are leery about sharing their rates with each other. Another difficulty is in deciding where to fall within the range of rates gathered. The middle of the range might seem like a good idea, but if the range is too broad or if the rates gathered don't represent the target market, a consultant could be locking themselves into a rate that, even with the type of cost-of-living increases that most clients will tolerate, may be difficult to change. This leads to chronic income shortages and can be the beginning of the end of the practice.

Overhead rates are another simple method and are calculated by taking the salary of the involved parties, adding benefits and an overhead charge, and finalizing the rate with a profit margin. The hardest part about using this type of rate is determining in the beginning what salaries and benefits may cost for the owners of the practice, but it does represent a simple and upfront method. A variation of this method is the *multiplier,* which simply takes salary plus benefits and multiplies it by a fixed number, usually 3 or 4.

Retainers are a pricing method that can be very effective when a consultant is trying to create a base income with one or more clients. Retainers are a very unique strategy in that each one is based upon the delivery of a very specific service or set of services in exchange for a set fee. The negotiations for the exact services to be provided are critical in making this pricing strategy work, but the payoffs are a stable source of income and service delivery.

The list above details a number of different methods for pricing. However, a consultant also benefits from an overall pricing strategy that can be applied to the multitude of opportunities to bid for work. Cost-based pricing and value-based pricing represent opposite ends of strategic methods (Ringle 2010; Walaski 2011).

Cost-based pricing is the more traditional approach, and something many consultants rely on throughout the life of their practice quite effectively. It bases the price for a service on the cost of providing the service, plus the consultant's desired profit margin. For companies selling a product, calculating the costs can be simpler, but for consultants, the costs are typically based upon the firm's fixed costs for items such as insurance, rent, office supplies, advertising, administrative employees, etc. For smaller solo firms, profit margins are unique to the consultant; for larger groups, the margins are agreed upon up front. Many consultants who are using cost-based pricing are interested in what everyone else is charging so they know how to price their services, since what everyone else charges becomes a very important factor for this type of pricing strategy.

Cost-based pricing doesn't take into the account the opportunity presented by the client's needs. The reality is that there are a lot of consulting firms out there, of all sizes and configurations, with expertise that varies from basic to advanced. In the pricing process, convincing the client that they need the services of the particular consultant is fundamental; otherwise, it can be performed by anyone. Basing services on cost alone can set a consultant up to perpetually be in the battle to be the lowest bidder. They may make money, but the price of performing "commodity services" can be grinding and unfulfilling professionally. What all of the other consultants are charging everyone is very important.

Value-based pricing uses the concept that the cost for a consultant's services is secondary and, until a perceived value is created in the mind of the potential client, the pricing strategy will be less than effective. Marketing services is designed to create perceived value in the minds of potential clients; successful marketing allows a consultant to benefit from that value. Value-based pricing takes much more time; first, by developing a relationship with a client, building value in their mind, and continuing to reinforce it. A consultant is positioning themselves as worth the money they will charge, even though the cost for services isn't even on the table in the early stages. (One way to know for sure that a potential client is being asked for a price-based quote for services is when the first question they ask is "How much do you charge for….?") To be successful in value-based pricing, a consultant needs to approach each opportunity with a client carefully, taking the time to understand the value of the service to them. Once the consultant understands the value and successfully communicates it to the client, they can begin to quantify the value they bring to the process.

One of the fundamental concepts behind pricing strategies that is helpful in understanding the differences between cost-based and value-based pricing is that there are three variables at work when a consultant offers a product or service in the marketplace: price, typically the lowest; quality, the highest; and service, the best and most reliable. Ideally, consultants can provide all three to their clients. Indeed, most clients do want all three, but the reality is that, in pricing services, a consultant most often needs to pick two, and only two, and focus their pricing efforts on those two factors.

Cost-based pricing tries to address price and service; the message to clients is that a consultant provides the most competitive (read: cheapest) price and provides the best service. In some cases, if a client just needs a sign-in sheet that shows they have run the workforce through their annual Respiratory Protection Refresher training (for the 20th year in a row!), a cost-based price can do it for them in a way that is the least painful to their training budget It may not be the highest quality training but it gets the job done, and the client's needs are met. And the value works both ways. A consultant makes money, and, if they have priced the services properly, makes enough to pay the bills for another month, at least until the client finds another consultant who will do it for half of what was charged. Now a dilemma has been created. Does the consultant let the client go or bid even lower? Or offer a discount? Or some free work on the side? The significant downside to cost-based pricing is that is becomes nearly impossible over the long haul to be profitable.

However, if a consultant focuses on quality and service, price is no longer the main issue. This doesn't mean that the consultant is free to charge any amount, and the client will acquiesce; there will still be a ceiling over which a client won't be able to go. But the consultant has significantly more room to offer their unique expertise. A needs-based training program can be developed that is challenging to both the consultant and to the client's workforce as participants.

There are obvious limits to this concept. If someone needed to buy a pair of sweatpants, and price is the most important consideration, they would most likely shop at Wal-Mart, Target, K-mart or any of the "big box" stores. Those stores effectively draw in customers initially because of the price, but they also offer service (smiling Wal-Mart greeters). The sweatpants may not be the best quality, but a customer has had their needs met. However, if a customer needs some workout clothing to wear to the gym to impress their fellow club members, they are more likely to go to a sporting goods store or another high-end store where they are not looking first at the price tag. (In the Mercedes dealership, the corollary is that if you have to ask the price….)

Along with the limits to choosing a cost-based or value-based pricing strategy, there are also opportunities. It is possible for a consulting firm to be both. Many consultants, including this author, start out being a cost-based type of consulting firm. When this author began her practice, the work that was performed was mostly freelancing. With two young children, a desire not to travel and for part-time work and a limited resume, lower-priced work for smaller clients was perfectly acceptable and plentiful. Slowly but surely, the amount of hours worked increased until it was nearly the equivalent of a full-time job. At that point, the amount of work was sufficient, but the question of profitability began to loom.

At the same time, two problems slowly began to surface. One was that professional development began to suffer. The boredom of doing the same training session over and over again began to take its toll. The need to extend and begin to use the skills and expertise developed along the way became more and more important. The second problem was that since the original fees were based on the price-service strategy, the practices' actual income was slowly eroding because the fees could not be increased enough to keep up with the cost of living. While the rates could be increased slightly for new clients, the ones that came back year after year did so because price and service were good. They weren't necessarily interested in paying a lot more, sometimes not even a little more. They were willing to move to another consultant, even though the work done over the years was appreciated, if the price charged went too far above their very, very, low ceiling. Since there was always someone willing to perform the same service for less, it became a constant battle to try and find new price-service clients while juggling the needs of existing clients.

There was always enough work out there providing commodity services with a price-based strategy, but that prospect wasn't very appealing. If the process had continued, it's likely that the practice would eventually have closed unless the cost of operating the practice and/or personal living expenses could be substantially reduced.

One solution to this dilemma was to hire a staff person who was interested in and whose current skills matched the price-service type of work, thus freeing up time to focus energy on finding clients and developing relationships that would eventually lead to quality-service type of work. At the time, that staff person was content performing the commodity services at a rate that met her needs and earned sufficient income to cover fixed costs and produced a generous profit. This scenario worked successfully for more than three years. In that time, sufficient work was booked to enable a full-time salaried staff person to be brought on board to handle the workload.

It can be difficult to give up a price-service mindset when approached for a quote for services. It requires the acquisition of new marketing skills and ways of finding and approaching potential clients. It also requires patience when working with a new client. And finally, it requires the ability to learn to answer the question ,"How much do you charge for….?" in two different ways, depending upon a quick assessment of whether the caller is a price-based client or a value-based client.

If there's one thing that continues to be important in the development of a consulting firm that remains successful over the years is that a variety of pricing strategies are necessary, and they must be based upon an assessment of the current factors and economic climate that affect the individual consultant. As noted in the introduction, many consultants are SH&E professionals turned business owners, not the other way around. The learning curve on the business ownership skills side is steep and requires a concerted effort as well as a willingness to do research on best practices. Understanding pricing strategies is a critical element in a consultant's success. Understanding the concepts between price-based and value-based pricing strategies offers consultants the opportunity to increase profits by understanding the client's needs first and finding ways to meet them before the conversation turns to price. It also gives a consultant the ability to continue to grow and develop as a professional and still be profitable enough to stay in business.

Insurance Considerations

The ASSE Consultants Practice Specialty group on Linked In featured a poll initiated in late January 2012 that asked the question, "Do you carry professional liability insurance for your business?" Of the 21 respondents, 24 percent indicated that they did not carry this type of coverage. Three of those respondents had been in business more than one year. These are interesting results for professionals who make their living helping clients manage their risks.

This paper will not expound substantially on whether or not consultants need professional liability and general liability insurance. This author agrees with the opinion that anyone who holds themselves out to be an expert in a particular area and offers a service in exchange for payment is at risk for litigation if the service delivery is believed to result in a compensable problem (Grisim 2006; 2007). A client's employee gets hurt following a training session conducted by a consultant on how to inspect and don a fall protection harness because the leg straps were not tightened sufficiently; or an OSHA inspection results in a penalty for lack of machine guarding that a recent audit by a consultant deemed to be in compliance are just two examples of thousands of potential scenarios associated with SH&E consulting. Any time a consultant fails to meet the standard code of conduct established by the profession, potential liability is created. Even if a consultant is not guilty of any infraction, anyone can and will be brought into a suit, leaving the enormous costs of defense up to the consultant being sued.

In addition to the above, consultants often make the mistake of believing that their corporate structure protects them from being sued through the so-called *corporate veil*. However, this only protects individual investors, owners, and officers from personal liability for corporation purposes. The veil can be pierced under some circumstances and, when that occurs, a consultant may be personally liable and be required to use their personal assets to pay a court-ordered judgment (Boop 2012).

All of those scenarios establish a risk to the consultant. The most common methods of addressing risk exposures are to eliminate the exposure, assume the exposure, reduce the exposure, or transfer the exposure. *Eliminating the exposure* eliminates the consulting work, which is hardly an option. *Assuming the exposure* is always a possibility, but the costs to any one individual make this highly unlikely. *Reducing the risk* through traditional loss prevention is a critical option. In the case of a consultant, this often means understanding and applying the applicable codes of conduct ,as well as other methods, such as professional development; utilizing contracts explicitly detailing the services and limitations; and engaging with clients that have been evaluated along some risk profile.

The most effective strategy then remains *transferring the risk* to an insurance company through the two traditional types of coverage most consultants utilize: professional liability and general liability. The first step in obtaining coverage is to find a reputable agent. Some characteristics to consider include someone who is educated enough about the work product to help identify exposures as well as methods to reduce them prior to relying simply on insurance. Once the exposure requiring coverage is clarified, the agent will market the consultant's needs through a variety of carriers to find the necessary coverage. This step can be difficult, since SH&E consultants are a very small market segment, and many carriers are not willing to write policies for them. Standard polices for SH&E consultants can be hard to find, requiring consultants to do some due diligence to assure that the agent understands the unique risks of their practice. Once insured, a quality agent will remain in touch with the consultant to monitor the needs and work with them at the time of renewal (Grisim 2006).

A couple of points require mentioning at the stage of identifying potential carriers and pricing. The first is, as with many other types of insurance, the premium can be reduced through the use of deductibles. Consultants should carefully evaluate the amount of retention they wish to assume. Sometimes a high deductible can be daunting, but the savings over the life of the policy, given than most consultants never encounter the need to use the coverage, can be substantial.

As with most insurance policies, exclusions will be attached to the coverage. The most common ones include fraud, intentionally dishonest acts, and copyright violations. Another limit often placed on coverage is exclusion for bodily injury and property damage.

In addition, and probably more critical than typical exclusions, is whether or not the policy is written on a claims-made basis, as most professional liability policies are. *Claims made* means simply that the policy in force when the claim is made is the primary one, as long as the retroactive date goes far enough back to cover the date of loss. If it doesn't, the policy will not cover it. If the policy is written on an occurrence basis, whichever carrier wrote the policy at the time of the occurrence of the claim is responsible to cover the claim (Grisim 2006).

Nearly all professional liability policy premiums are based upon revenues, which typically come from the application for coverage made by the consultant. It is important to be as accurate as possible; neither too high nor too low, as the latter scenario has the potential to create a serious problem if a claim is made. While most changes in revenues can be covered in the annual renewal process, a substantial increase (or decrease) should be reported to the agent so that a record is created, even if there are no changes to the premium.

In addition to the revenue projections made on the policy, the answers to other questions about the type of work that is performed are also important as the answers become part of the policy and may limit the coverage if a claim is made for a type of work tasks that wasn't in the application. In addition, some types of consulting, such as construction or engineering, generally create higher premiums. If not reported on the policy, claims made while performing this type of work may not be covered at all. Finally, the consultant's relationship to the client is a critical piece of information used to determine premiums. Consultants who provide direct supervision to client employees will see much higher rates as they are seen as providing direct service rather than consultation. Carriers may also establish requirements that all work be done through formal written contracts (something that is important for more reasons than insurance as well), and that all work products contain a disclaimer of some sort.

One last point about the carrier bears mentioning, and that concerns the financial strength of the company. Ratings bureaus such as A M Best, Standard & Poor's and Moody's must have given the company high ratings, particularly if the consultant wishes to utilize an umbrella policy to provide coverage above the limits of the base policy. Any indication that the ratings have dropped should indicate a need to change carriers as soon as is feasible.

The question of the limits of coverage is another question often asked. Returning to the poll conducted at LinkedIn, the most common answer was $1 million, which is an amount that seems to be fairly standard in the industry and tends to be sufficient protection. Sometimes clients will require coverage up to or in excess of $2 million (this author's anecdotal experience is that this level of coverage is becoming much more common), and consultants who are involved as subcontractors on large projects may also fall under specific coverage established by the owner.

A request that is often made to consultants is that they allow their clients to become an additional insured on their policies. While this may seem to be a simple request, consultants should tread carefully when agreeing to this. In the event of a claim, the limits of the policy in force are divided by the number of parties, leaving all of them with less coverage as individuals. A better alternative is to utilize Certificates of Insurance, which keeps the limits of the policy on place and provides the client with the assurance that proper coverage is being maintained by the consultants (Grisim 2006 and 2007).

SH&E consultants often fail to address an important component of coverage and that is *tail coverage*. This assures that there are no gaps in a consultant's coverage, as it goes back to the initial date when a consultant first started buying coverage. Tail coverage is also important when a consultant closes the business, as it will protect them for the period after the professional liability policy is ended for claims that have not yet been reported (Grisim 2006 and 2007).

The second, most common, and essential coverage that nearly all consultants require is comprehensive general liability. Such policies cover consultants against personal injury or property damage while engaged in work for a client. Examples include breaking a valuable piece of machinery attempting to evaluate it for lockout/tagout or rendering a Smart Board inoperable (i.e., breaking it) while using if for a training session.

Additional coverage that some SH&E consultants should consider include the following (U.S. SBA 2012):

- ***Home-based Business Insurance:*** Since most typical homeowner's policies would not protect home-based business losses, additional coverage may be necessary. Consider the need for protection from loss of business data; theft of business property, such as laptops and projectors; and some types of personal injuries that occur while working at home.
- ***Business Interruption Insurance:*** As noted above, homeowner's insurance or home-based business insurance may cover some damages from events like fires or floods that may cause damage to the home-based consultant's property, but they will not cover losses from the inability to operate the business for a period of time.
- ***Key Person Insurance:*** In a consulting practice with several participants, the loss of a key person in the organization may mean a substantial drop in the ability to generate revenues, either for a period of time or permanently. This coverage functions as a life insurance policy on the key person with the business entity as the beneficiary.

One last point that bears noting is the importance of regularly reviewing your coverage and comparing rates among several different carriers. Bringing changes in the practice to the attention of a reputable agent at least once per year is a good habit to develop. It is also wise to obtain quotes from several different agents not only at the start of obtaining coverage but also on a periodic basis. Insurance products do change over time and, given the cost of buying a variety of business insurance products, it pays to shop around.

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