

HOW TO START A

How do you go out

on your own without

going out on a limb?

Here are the business

basics you'll need for

making the break and

becoming your own

boss.

BY

GEORGE

KIMMERLING

To mix a metaphor, the budget ax never falls far from the training and development tree; often, it strikes directly. But rather than worry about how easily you could be out on the street, consider yourself just a paycheck away from being successfully self-employed.

Whether you choose self-employment or it is bestowed upon you, your climb up this new career ladder will be easier if you address some critical busi-

ness issues first. Because no matter how sky-high your eventual consulting income, every practice is built from the ground up on a solid foundation of smart planning.

Choosing a structure

How you structure your business will affect your tax and legal liabilities. In the United States, there are three basic types of business structures: sole proprietorships, partnerships, and corporations.

CONSULTING BUSINESS



Preparing a Business Plan

For yourself and for potential financial backers, a complete business plan is indispensable for specifying your market, your firm's fiscal health, and the scope of your services. A business plan need not be complicated, but it should contain the following elements.

A business description. Prepare a cover sheet, listing the business name, address, phone number, and owners. On the next page, describe the business's structure and the state where you incorporated (if you did).

Next, write in specific terms the principal activity of the business, information on the start of the business (for example, whether it is a new enterprise or the expansion of an existing business), the start-up date, the reasons why you think it will succeed, and the relevant experience you bring to the business.

Marketing plan. In this section, outline the demographics of your expected clients, identify the size of the market and the percentage you expect to penetrate, size up your competition, and detail your pricing policy and promotional plan.

Management plan. Identify the key players in your organization, including their duties, compensation, and benefits; list the professional resources that are available for ex-

ample legal and accounting help); describe your banking plan; and assess your potential for establishing credit.

Financial plan. As the blueprint for your company's financial health, this is the most critical part of the business plan. The financial plan should include the following:

- ▶ financial-planning assumptions (such as market health; start-up date; gross profit margin; and required overhead, payroll, and other expenses)

- ▶ profit-and-loss projections (a budget) for each month of your first year

- ▶ a source-of-funds schedule that lists where you expect to get financing and how you will apply the funds to your costs

- ▶ a balance sheet that indicates the amount of investment that will be required for the business and the amount that will go for working capital

- ▶ a cash-flow projection for the first year, to predict how and when money will enter and leave the business.

Adapted from "The Business Plan for Home-Based Business," Office of Business Development, U.S. Small Business Administration, Washington, D.C.

required to file state and local taxes.) Partners report the income and losses from the partnership on their personal returns.

Legally, partnerships can be nightmares. As a general partner, you are fully responsible for the liabilities incurred by the other partners, regardless of whether you had a hand in the activity or negligence that put you at risk.

Unlike the first two structures, corporations are legal and taxable entities that exist separately from the individuals who invest in them. That separation provides a fire wall of protection for investors when the corporation is sued or when the government believes it has not received its fair share of the profits.

Corporations, formed when investors transfer money or other assets for stock, are required to pay income taxes separate from those paid by the investors. The income and deduction rules that apply to individuals generally apply to corporations, but corporations are entitled to additional deductions.

In the United States, a special kind of corporation, known as an S corporation, is available to organizations that have fewer than 35 investors. All the shareholders must be U.S. citizens or residents, and the corporation must be organized in the United States or under federal or state law. As in partnerships, S corporations avoid double taxation on income to the corporation and dividends to shareholders. Instead, corporate income is passed on to the shareholders and reported on their personal returns.

Liability issues drove Lynda McDermott, a New York-based consultant for 15 years, to incorporate right away. "In our business, the chance that you are going to get sued is slim," she says. But "the cost of professional liability insurance was prohibitive." McDermott wanted to keep her company small, but she knew that, down the road, she would want to employ an administrative assistant. A corporation seemed like the right structure in which to achieve that goal.

McDermott's company, EquiPro International, now employs three full-time staffers—a workforce she augments with subcontractors hired on a

Sole proprietorships are the simplest business structure. They have no separate legal existence apart from the owner, and they have no additional tax liabilities apart from the owner's liabilities. The owner's Social Security number generally serves as the company's federal taxpayer-identification number, and federal tax reporting of income and loss from a sole proprietorship requires only an additional schedule filed with the Internal Revenue Service 1040 form.

The simplicity of sole proprietorships is also their danger. They have no legal existence separate from you, the owner. So any liabilities—tax, legal, and otherwise—that befall the business become your personal liabilities. In other words, if a client sues you for not living up to your contract,

all your personal assets are on the line.

Partnerships generally permit those participating to share expenses and profits, either equally or on a predetermined percentage basis. How partners will share the gains and losses of the business should be established in the partnership agreement. That decision is generally related to the amount that the different partners contribute in money, property, labor, and skill.

Like sole proprietorships, partnerships are not separate entities for federal tax obligations. But they must have their own IRS employer-identification numbers, obtained with IRS Form SS-4, and they must file a partnership return, even though they pay no federal tax. (Partnerships may be

per-project basis. EquiPro grossed \$750,000 in 1994.

The tax collector

Regardless of the type of business you establish, you will have new tax obligations as a self-employed person. The most important are your quarterly estimated income-tax payments and, as part of those payments, your self-employment taxes.

When you are employed by an organization and file your taxes every April 15, it is easy to believe that taxes are a once-a-year obligation. They are not. By withholding taxes from each paycheck, your employer helps you pay off your tax debt during the course of the year.

As a self-employed person, you must still pay your taxes throughout the year, generally on a quarterly basis. You do that by filing estimated tax payments on April 15, June 15, September 15, and January 15.

In addition to your income taxes, you are also required to pay a self-employment tax, which covers your Social Security and Medicare taxes. One-half of your self-employment tax is deductible in figuring your gross adjusted income.

When it comes to taxes, don't go it alone. The federal tax code is a complex web of rules, conditions, and exceptions. Hire an accountant or tax attorney to guide you. You be the expert in organizational change; let someone else be the tax pro.

Home alone

Recent advances in telecommunications capabilities and the entrance of family issues into human resource discussions have led many professionals to consider working at home, at least part-time. When you are considering working for yourself, being able to live and work under one roof sounds like a dream. It means freedom from rush-hour traffic jams and from concern about being at work on time. It means more time with the kids and a chance to read the newspaper rather than skim it.

Working at home may solve the short-term problem of locating and leasing office space. But it also poses some hurdles, both to your productivity and your business.

Establishing an office outside your

Marketing Tips for Consultants

By Haidee Allerton, an associate editor for Training & Development magazine.

Just like boxes of cereal on a crowded supermarket shelf, you need brand recognition—something to make your product (you and your expertise) stand out from the competition. You'll be better able to sell your services if people get to know who you are and what you have to offer.

Here are some self-marketing strategies for increasing your visibility and establishing yourself as an expert, from Nancy Michaels of Impression Impact, in Concord, Massachusetts:

- ◆ Cultivate new contacts by joining and becoming actively involved in professional organizations. Keep in touch with your business contacts. Call them, send notes and items of interest, and acknowledge holidays and special occasions. Maintain an accurate, up-to-date data base of names and addresses.

- ◆ Be personally involved in your marketing efforts—the star in your own promotional materials. (Think of what that did for Frank Perdue!)

- ◆ Get your byline in print. Write articles about industry trends for trade journals, local newspapers, company newsletters, and professional-association magazines. Buy reprints or ask permission to make them yourself; send copies to clients and prospects.

- ◆ Seek opportunities to speak to industry organizations and local business groups such as the Rotary Club.

- ◆ Produce a regular newsletter with news about clients and prospects, informative feature articles, reading lists, notes on media coverage you've received, new-product mentions, and a letter from the editor—you. Use the same colors in your newsletter that you use on other company materials to present a consistent corporate image.

- ◆ Enter your projects in industry-award competitions.

- ◆ Develop a niche market and go after it.

- ◆ Think of a unique direct-mail program that's geared to your specialty. Invest in professionally printed materials.

- ◆ Create a press kit. Include a continually updated press release, your biography, a formal head-and-shoulders photo, reprints of articles written by you or about you, testimonials from satisfied clients, and a business card.

- ◆ Give good referrals when you can't accept a job. Never disparage the competition.

- ◆ Do the job you promised.

Whether you're in the start-up phase or expanding your business, spend time on your marketing efforts. No matter how competent you are, if prospective clients aren't aware of your business, you won't be hired.

home can give your business a more professional appearance—and a place to meet clients without the interference of domestic concerns. Those concerns can be distracting, especially when you are facing a tough project that challenges your concentration. It may be easier to snack or to put a load of laundry in the washer than it is to tackle a budget or begin writing a proposal. And when you are trying to spend quality time with your family, the sight of paperwork on your desk becomes a tiresome nag.

"I could not bring myself to work out of my home," McDermott says of

her first year out. When she began, in the early 1980s, home offices were not in vogue and telegraphed an unprofessional image to potential clients.

McDermott chose instead to lease space in a shared office, where other entrepreneurs provided camaraderie and support, and where clerical help was available, which McDermott paid for only when she used it. The arrangement afforded her lower overhead than renting her own offices and hiring full-time administrative support. "It was a very good alternative," McDermott says. "It was a great way for me to start."

Fifteen years later, she says, office location is a non-issue, because of both the changing times and her track record. "Once I established my reputation," she says, "my clients didn't care where I worked." And, with the ability in New York City now to rent fashionable mailing addresses and conference space, consultants can operate from home and retain a professional public image.

If you decide that home is where you want the heart of your business to be, you can take several steps to make it easier on yourself:

- ▶ Have a separate room for business.
- ▶ Rent a post-office box.
- ▶ Install a separate phone line for your business.
- ▶ Identify insurance, zoning, and licensing requirements.

Establish a separate room for business activities. In the corporate environment, shutting the door to your office can discourage people from "dropping by" with questions and requests. Similarly, shutting the door to your office at home can provide a useful barrier between work and domestic demands.

And if you hope to take advantage of the IRS's home-office deduction, having a separate room dedicated only to your business is critical to passing an audit. The IRS also wants to see that your home office is your primary place of business.

If you plan to see clients at home, consider whether inexpensive renovations could give you a separate entrance. If you have the space, you might even want to think about a separate structure for your office.

Rent a post-office box. If your home address is obviously residential, consider renting a post-office box to receive your business mail. If you live in an apartment, you can substitute "Suite" for "Apartment" in your address.

Install a separate phone line. It may seem cute the first time your four-year-old answers the phone and an important client is on the other end. But it can raise doubts in the client's mind about your professionalism.

Unless you will always answer your personal telephone line by giving your company's name—and unless you are willing to leave a professional message on your answering

machine—have the telephone company install a second line, dedicated to your business. A business line typically costs more than a residential line, but it can keep you organized and your clients confident. And you may need a second line for your fax machine and electronic mail.

Know the insurance, zoning, and licensing requirements. What if clients injure themselves at your office? Your homeowner's or renter's insurance may not cover business assets or liability.

Many cities require you to purchase a business license or a home-based business permit before you can legally run a business from home.

"IT'S NOT A
MATTER OF WHAT
YOU ARE WORTH;
IT'S A MATTER OF
WHAT YOU
CAN GET"

Zoning regulations—and the bylaws of your condominium or cooperative—may prohibit home-based businesses. Know where you stand.

Money, money, money

Let's face it: Realistic or not, the expectation of a sky's-the-limit earning potential is one of the strongest lures to consulting. But establishing a fee schedule can be daunting—especially a fee schedule that will be acceptable to the clients you want to target and that will cover your expenses and earn you the profit you want, however much that is.

Don't set your fees by figuring out and trying to earn what you are worth.

"You are not worth anything," says Geoffrey M. Bellman, a consultant for 17 years and the author of *The Consultant's Calling*. "It's not a matter of what you are worth; it's a matter of what you can get."

No working person—professional baseball player, teacher, or rock star—is worth what she or he earns, he says. And to confuse what you earn with what you are worth only

complicates the fee issue with questions of self-esteem. Bellman, based in Seattle, Washington, charges clients in the Pacific Northwest \$2,000 a day plus expenses; he charges clients in other regions \$3,000 a day. His corporation, GMB Associates, provides change consulting to top executives.

Two of the most basic considerations in figuring your fee are how much money you need and how much more you want. You need to cover your expenses. Unless there is fat in your personal or household budget, you probably also need to maintain your current income. To figure your current daily rate as an employee, divide the amount of your annual salary by the number of paid work and leave days. The resulting amount is your current daily rate, which you earn when you work and when you don't.

If you are a consultant, clients pay you only for time spent on their projects. Thus, you must build into those fees enough money to cover the time you spend marketing your services, developing your skills, and enjoying time off. If you want to spend half your time on these activities, double your current daily rate.

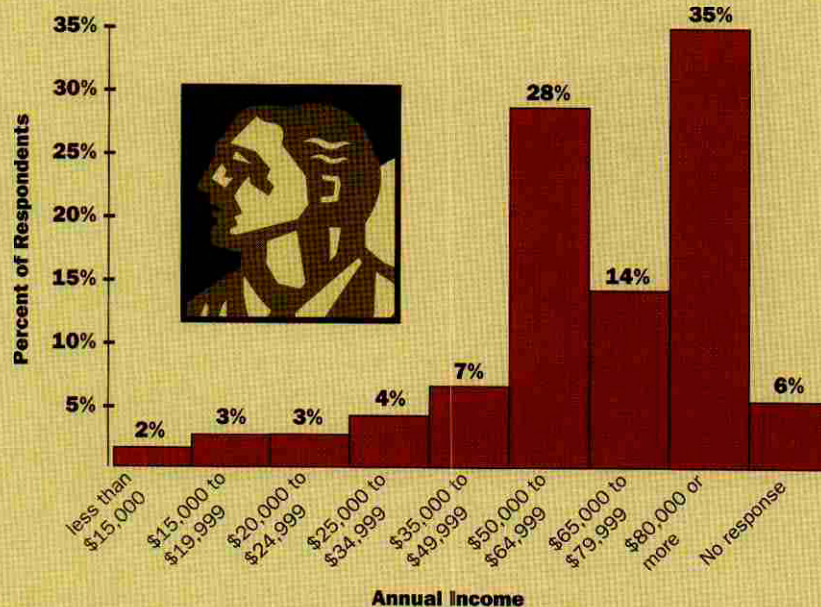
That still may not be enough. Consultants must bear many of the business costs once covered by their employers. Those include marketing costs, as well as such tangible business assets as equipment, such overhead costs as office rent and utilities, and such personal expenses as health insurance. The Small Business Administration recommends that you figure operating costs at half of your annual income.

Once you have the end result, check it against the market in your area to see whether you have priced yourself appropriately. Contact colleagues or other service providers, such as local universities, to learn what they charge for similar work. Consider what your former employer was willing to pay outside providers.

Your fee should be somewhere in the middle of the extremes. Pricing yourself too low can lead you to resent your clients and can lead potential clients to think you are not as effective as your higher-priced competition. But a new consultant without much of a track record might

How Much Do Consultants Make?

A 1994 survey asked a random sample of *Training & Development* magazine readers, "What is your annual income before taxes?" Of the 819 readers who filled out the survey, 118 classified themselves as independent consultants; the responses of that group only are reflected in this chart.



The readership survey was conducted and tabulated by Association Research Group. Percents do not total 100 because of rounding.

not be able to win contracts at higher prices.

Consultants who are new to the game commonly make two errors in setting their fees, says Bob Younglove of Path Associates in Baltimore, Maryland. "The mistake most people make—and that I made when I first started out—was looking at my worth in comparison to what I was making as an internal training specialist—and not realizing it was far below what companies expected to pay. Consequently, they would look at my fee and say, 'Well, he must not be any good.'"

The second most common mistake, Younglove says, is billing clients only for time spent actually delivering services.

"Most people, when they start out, don't bill for prep time," Younglove says. They mistakenly figure their billable hours by counting only the days spent in training delivery. Instead, he advises consultants to "look at the amount of time they spend at their computer and realize they have to charge for that, too."

Younglove charges \$1,400 a day

plus expenses for program delivery and half that for design and other preparatory work. He works 12 billable days a month and earns \$150,000 a year from consulting.

The advantage of having a daily rate, he says, is that most companies calculate their budgets on that basis. After establishing a daily rate, Younglove and the client then figure how many days the project will take, in order to come up with the project budget.

Proposals and contracts

An effective proposal describes the expectations and responsibilities of both the client and the consultant. A good proposal can win clients and avoid misunderstandings as the work proceeds.

In Younglove's consulting practice, proposals grow out of an initial client meeting, in which the client describes the desired end result—the change or outcome he or she expects as a consequence of the training intervention. This meeting also provides Younglove with the chance to assess whether the services he offers are the

right match for bringing about the desired outcome.

The proposal first describes a rationale for the intervention—for example, why better time management would increase productivity. Next, the proposal lists the client's goals and includes a clause that allows the goals to be refined as the project gets underway.

The most complicated part of writing a proposal is describing the scope of the intervention. This part of the proposal sets out each step of the process, from needs assessment to evaluation. Then the proposal lists the time needed to accomplish each segment and sets a price for each. By listing the price of the project's components, Younglove says, you avoid the "sticker shock" that can result if you communicate only the total price to a client.

The proposal also can include a preliminary time line that lists the dates on which each part of the project will begin and end. Every schedule will need revising. But writing down the project milestones and their deadlines helps discipline every player in the process—and allows each party to unearth all the tasks that contribute to a satisfactory outcome.

An accepted proposal should feed into a contract—or, more simply, a letter of agreement. Some clients have standard contracts that they ask all consultants to sign; if you can use your own contract, keep it simple. The agreement need only identify the parties, the services agreed to, the party that will provide each service, the beginning and ending dates for the project, specific costs, and an acceptance clause that representatives from both the client firm and the consulting firm can sign.

Not every successful consultant bothers with contracts. Bellman, for example, rarely writes them; he views them as dangerous. Contracts can ruin the consulting relationship, he says, because they can "freeze" into place each party's responsibilities—when, in fact, those responsibilities should evolve with the consulting project.

"I think it is important that we understand what we expect of each other—what we are going to give, what we are going to get—and that we understand these in pretty specific

terms. I seldom feel compelled to write that up in contractual form."

Bellman uses an informal memo to clarify what the project will entail and how the intervention will be planned. But he does not view such a document as legal protection or as a barrier to altering the nature of the work. "Not having the written, legalistic contract promotes discussion between me and my clients," Bellman concludes.

Looking for help?

When you land a job that's too big for you to handle alone, you may choose to hire an independent contractor to perform part of the work. From a tax standpoint, independent contractors offer you the advantage of not having to withhold income taxes or pay any share of their Social Security and Medicare taxes.

But be careful. The IRS has strict rules for determining whether someone who is working for you is an independent contractor or an employee. For the most part, professionals who offer their services to the general public are not employees when hired on a project-specific basis. That includes training and development consultants. But the facts in each case dictate whether a person you pay to work for you is an employee or an independent contractor.

If you control or direct only the outcome of the work—but not the means and methods of accomplishing it—then you have hired an independent contractor. An employer/employee relationship exists when the person who pays for the service has the legal right to control both what must be done and how it must be done. And that kind of relationship subjects the employer to the associated tax obligations.

Two other characteristics of an employer/employee relationship:

- ▶ The employer has the right to discharge the employee.
- ▶ The employer supplies the employee with tools and a place to work.

Younglove's Path Associates is a sole proprietorship. To avoid the liabilities that come with employees, he subcontracts for services from three kinds of people: trainers who will deliver a program that he has designed and that has proven to be effective,

"CONSULTING IS NOT JUST MAKING A LIVING"



other professionals who have expertise in an area that complements Younglove's abilities, and people who perform support services such as clerical and marketing activities.

When Younglove needs help with support services—such as writing his client newsletter—he turns to Towson State University, located outside Baltimore.

The school's intern program allows Younglove to review the resumes of graduate students in the human resources and business-writing programs and to hire the ones who are best suited for the work he needs done. Younglove pays the university a fee of \$4,000 for the services of a student who works 10 hours a week for 10 months. In turn, the university pays the student a stipend.

To clear IRS review for his other subcontractors, Younglove hires them solely on a project basis; he has no ongoing contracts. A letter of agreement stipulates the terms of the project, its timetable, the site where the work will take place, and the subcontractor's duties and price. Younglove does not decide how the work is to be accomplished.

"Under the IRS regulations, if I am directing this person's work, then the person is considered to be an employee," he says. "What I give subcontractors is a project to do the way they want to do it."

These subcontracting arrangements, Younglove says, are the future of training and development, because they allow professionals to share each other's expertise without financial entanglements or complicated contract-

ing relationships. What they don't provide are a regular paycheck and health insurance.

New consultants can become subcontractors as a means of gaining experience.

Dede Bonner, for example, spent half her time as a new consultant working for other people. With the rest of her time, she built her own practice, New Century Management, in Leesburg, Virginia. Subcontracting allowed Bonner to "see what worked and didn't work for other consultants, from a lower-risk perspective," she says. "It also was a way of just doing the work without having to run the business, manage the contracts, keep in touch with the client, and perform all the work that goes on behind the scenes."

More basic than business basics

You may have laid to rest all your concerns about the business end of consulting. You may even begin to make mountains of money. But on a personal level, you still may not succeed as a consultant—unless you keep your work in perspective. Consulting should be an integral part of your life, Geoff Bellman says, but it shouldn't be all-consuming.

Your consulting practice should also contribute to the community and to your personal growth. "Consulting is not just making a living," Bellman says. "It is making life in your community. Ideally, you get to be yourself and grow yourself through the work you do."

For Bellman, consulting is a vocation. "That's the stuff that gets me up each morning; that's the stuff that causes me to continue to find new energy for this work. If you can't find consulting work that allows you to become yourself more fully," he says, "don't do it." ■

George Kimmerling is a Washington, D.C., writer.

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