

The Independent Consultant as Equilateralist

by Harvey Bergholz, Jeslen Corporation

© Jeslen Corporation, 2000

A Matter of Orientation

Long term, most independent consultants will subsist at best and starve at worst. The tragedy lies in the ease with which both can be replaced by success. It is a matter of orientation and most independents have the wrong one. They do not see themselves as business people. They might see themselves as consultants, as Human Resource Development professionals, as system integrators, as management theoreticians, as performance technologists; as most anything but business people running a small business, out to earn a profit (no, Martha, it is not a dirty word).

The Three Skill Sets

Three different sets of skills and traits are important to long-term success: those in the technical competence area, those required of a consultant, and those where many are weakest--small business management. The three sets of skills and traits form an equilateral triangle (see Figure 1). Were you to take a quiz on all three, chances are your score would be lowest in small business management.

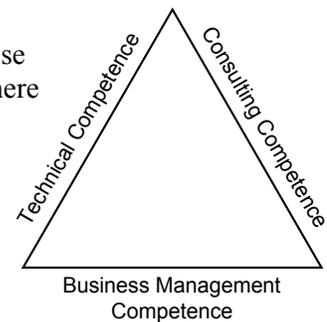


Figure 1 - Success Triangle

For example: Are you a corporation, a Sub-S, or a partnership? Now that you have answered that, explain why you chose the form that you did. If you finish your fiscal year with \$25,000 left in the kitty, how much will the government take? What will you do with the remainder? How will you divide it among the three uses for profits (reinvest in the business, hold as cash reserves, and distribute to the owners as dividends)? Assuming you are incorporated, who pays for your disability insurance -- you or your company? (The answer could mean a substantial difference in the net benefits received.) Quick: how much business must you do in a year to cover all your expenses, including deposits to a pension or profit-sharing plan? And while we are at it, what is the difference between a pension plan and a profit-sharing plan?

The aspiring independent who cannot answer these and perhaps a hundred other questions might not belong in business as an independent consultant.

My observation of consultants who do not make it tells me their orientation is not that of a business person out to build a successful (i.e., profitable) small business. They are not equilateralists. Perhaps they have an isosceles profile: technically strong, with solid consulting skills, but little know-how in the third critical area. In fact, for most, when they lose the option of remaining independent in their professional area, they choose to stay in the field, though not in their own businesses.

At the other extreme is the entrepreneur who considers the type of business secondary. It is being in one's own business that counts. Which would you choose: remain in the field, or remain in your own business even if it meant switching fields?

You have seen the results of the weakness of which I speak: the competent pro who sets up shop and folds in two years; the firm with a "name," five practitioners, a few large contracts, and closed doors six years later; the "jumper" who goes from corporate job to independent consultant to consulting firm and back to a corporate job.

For some, the impetus for setting up shop is the lure of bigger dollars. For others, it is the idyllic notion of blazing new trails. And for still others, it is the freedom bug: "nobody to answer to" is a typical description. As objectives, these are little more than stairways to black holes for the eager-to-be-independent.

"Nobody to answer to." That is silly. People who say that are saying they do not understand what it means to manage a business they also happen to own. As an independent, you answer to more people than if you worked for someone in a company. You answer to the IRS, state and local authorities, the better business bureaus, clients, employees, peers, your accountant, your attorney, the Labor Department, and yourself.

The Right Reasons to Open Your Own Shop

The right reasons to open your own shop are simple: (1) you have identified a need in the marketplace that needs filling; (2) you have the ability to fill that need; and (3) you have an entrepreneurial streak dominating your central nervous system; that is, you possess -- in massive doses -- these qualities: self-discipline, a willingness to take risks, a sense for marketing yourself, a long-term perspective, an ability to respond under pressure, an over-sized ego, and a need to own something. Note that most of these traits have little to do with competence in consulting, or any particular technical competence, and that is the critical point. The traits and talents leading to success in business are quite different from those necessary to succeed on the other two sides of the success triangle. No wonder so few succeed long term. It is tough enough mastering one set of skills or traits, or even two -- but all three? Have we not seen the engineer whose technical competence as an engineer was the chief reason for being moved up to the managerial level? And have we not seen such people fail for lack of the different traits and skills needed by managers? That or we have created programs to help them succeed. There are abundant instances of competent practitioners in many fields who decide to make the quantum leap from corporate life to consulting (or worse yet, go from teaching to consulting), and then geometrically compound the difficulty by starting their own firms.

But there is hope. Given sufficient competence in the technical and the consulting legs of the success triangle, the would-be independent does not have to fail. The most easily mastered leg is the business management leg, and following a few simple precepts will compensate for a lack of many of the entrepreneurial traits mentioned earlier.

As a starting point, I will share some of my own and most ardently held commandments. These relate only to the small business management aspect of our particular business. I could cite other, different commandments were we discussing consulting success, technical success, or even success in other types of small businesses.

Thou Shalt Understand Asset Management

It is money that makes money. A corporation has a lower tax rate than an individual. Earn a profit, give the government a relatively small cut, and then put the profits to work earning more money. "Crafty Consultants, Inc." has built up \$40,000 in retained earnings over the past few years. That money earns another \$2-3,000 a year just sitting in a money market fund. These earnings, to the corporation, are no different than consulting billings, and Crafty is being conservative. Once the owners feel secure enough, they may consider stocks, real estate, or other opportunities. (For more on Asset Management, see the commandment dealing with overhead.)

Thou Shalt Understand Business

Check your bookcases: loaded with Mager and Knowles, right? Even a few how-to books on consulting you have never really read (probably wise). But how many books on small business management and entrepreneurship? How many on marketing or finance?

The independent should have a firm grasp on what makes corporations -- big and small -- go or not go: how else will she be able to speak the client's language? How else will he make intelligent decisions for his own firm? It is time to go back to school if your eyes glaze over at the mention of RONA (Return on Net Assets).

Some people, perhaps most, see their businesses as a means of practicing their craft. That is a very different perspective from seeing their technical specialty as a marketable commodity that provides the means to be in their own business. Cross over to the small business perspective (you do not have to stay there), and you will realize there is much to learn to be successful long term. Learn what you need to know, and then feel free to cross back over to either of the other two legs of the success triangle.

Thou Shalt Hide in the Closet When Thou Seest Overhead Coming

Overhead is the great seducer. The "lure of the bigger" is tough to resist, but resist you must. Experience a little success, and the average independent will sucker for a bigger office, or a bigger car, or a bigger staff, or a bigger typewriter. Forget it. Live like a monk the first few years, and then move up to Abbott's status later. Remember your asset management program: putting your assets into "bigger" rarely pays off the way people say it will. "I need a high-speed copier -- with enlargement and reduction capabilities -- because of all the copies I make." Well, take it to the near-by copy shop, or persuade your clients it makes more sense for them to make the copies at their place, or work at the small copier yourself until midnight; but do not spend that \$5,000 until you can no-doubt afford it, and here is why: it will cost you a lot more than the \$3,000 price tag.

Take Crafty Consultants, Inc., with gross billing last year of \$100,000. After all expenses, including federal taxes, the company is left with a net profit of \$10,000. Not a bad year. That is a net margin of 10%. Crafty is going for the \$5,000 for the high-speed copier. Question: How much will Crafty have to bill, or have much did they have to bill, in order to buy it?

The answer is \$50,000. The question is not whether the machine is worth \$5,000C it probably is. The question is whether it is worth \$50,000 of Crafty's billings, which it probably is not. Given Crafty's 10% margin, it takes \$50,000 in billings to net out the \$5,000 to pay for that high-speed copier. As Adam Smith pointed out in Chapter Five of *The Wealth of Nations*: "The real price of everything, what everything really costs to the man who wants to acquire it, is the toil and trouble of acquiring it."

And we have not even considered the bunny-rabbit nature of overhead: it multiplies before your very eyes. Crafty, Inc. will have to support that machine, which becomes just one more corporate mouth to feed: backup supplies, perhaps a specially trained operator, rearrangement of physical facilities, and the hidden costs of the time to learn to use the machine and the time taken up playing with it the first few months before it begins gathering dust. Overhead: run and hide.

Thou Shalt Diversify

This commandment is as axiomatic in the stock market as it is in eating, and it should be so in small business consulting as well. You take the \$225,000 project with Megabusiness, Inc., and I will take five \$40,000 projects from five different clients, and I will be in business long after you have sold off your high-speed copier.

You will cringe at recession headlines, lose sleep over client personnel changes, and eat up months of normally productive time planning and haggling over the work to be done, instead of getting it done. The entrepreneur takes risks, it is true, but putting all your billings into one basket is too risky, regardless of how closely you watch the basket. One other thing: you wanted independence. The surest way to lose it is to hang just one basket on one nail, and then give the hammer to your one client.

Thou Shalt Not Build: For a Long, Long Time

Maybe never. Traditionally, building means adding people, and though it feeds the ego, and might even be productive on isolated projects, long term it is generally a lose-lose for the S.T.C. (do you bill less than a half-million a year? Congratulations: you're a Small Time Consultant). First, the overhead. What will it cost you to put someone on staff at \$35,000 a year? It will not cost \$35,000; it will not cost \$40,000; you might get away with \$50,000 if you do a good Silas Marner impression. There are benefits, and then the bunny-rabbit overhead. Consider also all the hidden time of working with, training, supervising, lunching, discussing, explaining, and on and on.

And echoes of Robert Townsend: how much of what "made you great" will you stop doing? You are likely to do less of the work yourself, at least for a time, and is it not precisely for your own brand of work that clients are throwing money at you?

How do you find good people? More important, how do you hold on to them? If the person is as good as you think, why does she need you? If he is not so good, why do you want him? If they are not so good, but you see yourself as Professor Higgins and figure you can mentor or train them, are you able (i.e., time and money) to support that effort? And once they are performing well, how will you keep 'em in front of their PCs once they have seen the billings and the board rooms?

In short, you are running big risks when you add people: deteriorating quality of output; unaffordable commitments of time and capital; and potentially, developing your own future competitors. If you need or want additional people, wait until you can truly afford them (asset management), or work toward establishing contacts within the field a network of sorts. You can subcontract some work out, or hook up with others for larger projects, and you will avoid the risks that go with building your own staff in the early years.

After a time, when you have built up your assets, you might want to test out the old theorem that the real profits are made by the people who work for you. It works in law firms, it works in accounting firms, and it even works in large consulting firms. I wish you luck.

Thou Shalt Know Thy Limits

Bite off more than you can chew and even Dr. Heimlich will not be able to save you. Know when to call for help. Just as that applies to the technical and consulting sides of the business, so too does it apply to the business management side.

Work with your accountant, your attorney, your insurance agent. Talk with your "network" friends about how they are handling situations, and use their good and bad experiences to help create good ones for yourself. My advice on outside services is to challenge them. Do not believe that because "Georgia is a CPA," Georgia knows what is right every time. She cannot; no one can. You are, after all, likely to be a relatively small fish in your accountant's pond, and to avoid being fried, you will need to learn. You need not go nights for an accounting degree; just learn enough so you can bait your own hook occasionally to let Georgia know you are sufficiently knowledgeable and skeptical so that she will need to rise to your occasion.

Thou Shalt Ask Thyself Once Each Day...

"What do I have to do to make this business more profitable long term?" That is the most important question. Not, "How do I make the business grow?" Nor "What must I do to be more effective technically?" It is through answering the first question that you get to the others. It is the first question that should drive your decisions (e.g., "Long term, I'm going to need greater technical breadth to get into the hardware side of the business, which is in demand and growing. For the long-term success of the company, I'd better begin picking up that know-how.")

I have a friend who owns a small camera store in a small suburb. Along with all the accessories, film, and low-to-high-priced cameras, he also carries a camera line whose prices begin in the stratosphere. In the past five years he has sold but two of them. In other words, they contribute little profit (actually none, given the inventory-holding time, interest charges, shelf space taken up, etc.). I asked him why he bothered. He answered:

"Personally I love the camera. I enjoy just showing it to people, including the ones who'd never go for it. It's unprofitable for me, and that's why I didn't take it in for my first six years in business here. Now that I'm solvent, have a steady trade, make a consistent profit I can live with, I can afford to indulge myself a bit in what I carry. It doesn't help my bottom line, but it helps me emotionally."

You want to work on projects that are interesting but unprofitable? Fine. But wait until you can afford those luxuries. It is not necessarily the doing of unprofitable things that leads to failure, it is the doing of them at the wrong time.

Thou Shalt Be Liquid

The independent without at least four months' worth of expenses in very liquid assets is a Chapter 11 waiting to be written. Especially in such uncertain economic times as now, the independent must have solid financial backup, and four months of expenses is a minimum. Peter Drucker says it clearly in his book, *Managing in Turbulent Times*: "In turbulent times, liquidity is more important than earnings. A business can survive long periods of low earnings or low revenues if it has adequate cash flow and financial strength."

A Cadillac, a plush office, a high-speed copier, and five people on staff do not represent financial strength, cash flow, or a highly liquid position. The issue for small service businesses, is not merely one of being able to pay the bills during the lulls -- the emotional well-being of the owner, in my own experience, is more critical to the business' long-term survival. For most independents, paying the bills is manageable during a lull: you borrow a little here, you dump some personal money into the business there, you sell the Caddy, and you fire four people (I know, firing people is not quite as painless as it sounds). The real problem is the owner's emotional reaction. How would you react to managing a "distress sale" of your prized possessions? How poised, confident, and self-assured would you appear when a potential client does call? Would you be ready to capitalize on the opportunity, or would you come across as Don Knotts?

The legs of the success triangle are very much interdependent. Your company's financial strength will provide the security needed to help you function effectively in the consulting role; and a comfortable cash flow will enable you to work on the technical side without the distraction of creditor phone calls.

For me there is another issue as well: control. On the technical and consulting legs, we usually share control over decisions. On the business management leg, I have the greatest freedom to make the decisions affecting my own future, and that is the reason I went into my own business in the first place.

About the Author

Harvey Bergholz is president of Jeslen Corporation, a consulting company he has headed for 25 years. His for profit clients range from small (\$100 million) companies to multi-billion dollar global giants. His nonprofit clients include health care, religious, and educational institutions. His practice centers on providing senior executives with counsel and assistance in shaping and implementing large-scale, high-impact initiatives. Harvey also numbers among his clients some of the world's largest consulting firms. He may be reached by phone at (630) 455-9944 and by e-mail at Harvey@jeslen.com.