

EMPLOYEE COMPENSATION FOR A CONSULTING PRACTICE

The everyday operation of a counselor's office is presented for discussion and a sharing of ideas.

by **Stephen Rushmore, CRE**

Compensation is an important element of any employment environment, and remuneration for production and effort generally takes the form of tangible payments-monetary considerations (i.e. salary, overtime, bonuses) and specific benefits (i.e. medical and life insurance, sick days, vacations, holidays, educational assistance). Also important to an employee are the nonmonetary benefits such as the work and office environment, job title, status, perks, learning experiences and opportunities for personal growth. A well structured employee compensation program can provide production motivation, quality assurance and job satisfaction.

Very little has been written about compensation programs for consulting organizations. Such firms are often staffed with bright, independent thinking individuals requiring high levels of monetary and nonmonetary rewards. This article describes the compensation package utilized by my firm—Hospitality Valuation Services, Inc., Mineola, New York. I hope by sharing my company's innerworkings, others will follow suit and offer their ideas in the area of employee compensation.

Background And Structure Of The Firm

Hospitality Valuation Services, Inc. (HVS) is a consulting organization specializing in hotel-motel valuations, market studies and counseling. Organized five years ago, the staff has grown rapidly from an initial one associate and one editor to the current 16 associates, four editors, two production assistants, one secretary and a college intern. HVS operates on a nationwide basis from its New York office serving a broad client base of hotel companies, developers, lenders and municipalities. While providing a variety of hotel related counseling services, the end product is typically a comprehensive, detailed written report ranging in length from 100 to 200 pages and costing between \$20,000-\$30,000. Each

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assignment is normally performed by one associate who devotes an average of three to four weeks per study.

Because of the unique expertise required to render hotel related counseling services, HVS has hired only hotel school graduates for the associate staff. Six of the 16 associates were recruited directly from college with 10 associates coming from varied backgrounds in the hotel industry. Three associates have masters degrees in hotel administration; 13 have bachelors.

The four editors are responsible for proofing and editing the reports which each associate imprints on a network word processing system. The editors develop the necessary charts and tables, perform the pagination and conform the report to the firm's editorial style. Each report usually requires moderate to heavy editing that takes approximately one week of editorial time.

An English degree or a strong journalism background is necessary for the editor position. Although each associate has ultimate responsibility for the integrity of the final product, the editorial function is the primary monitor for quality assurance.

The two production assistants are responsible for assembling and binding the final reports which are each typed on word processors. They prepare all the graphics including maps, computerized graphs and laminated photographs, and maintain the data files, office library and supplies.

The secretary types all the correspondence, proposals, invoices, articles and other nonreport documents.

Ownership Structure And Objectives

Hospitality Valuation Services, Inc., a New York corporation owned jointly by Judith and Stephen Rushmore, is a cash basis taxpayer with a November 30th fiscal year. Over the past five years HVS has minimized its tax liability by distributing the majority of its profits in the form of salaries, profit sharing contributions and bonuses.

Several ownership objectives have been established for the future which include continuing to provide clients with the highest quality hotel counseling services; expanding the product line (services) into other hospitality related areas, i.e. ownership, financing, management, development, syndication, etc.; controlling growth by continuing expansion of the New York office and the establishment of regional offices in selected U.S. cities increasing client base through the development of new products and continuing penetration into markets and services currently dominated by other consulting organizations; promoting the generic identity of Hospitality Valuation Services, Inc., rather than the individual reputation of its founder; minimizing employee turnover in order to prevent losses to competing consulting organizations.

Organizational And Employment Philosophies

The key component of any counseling organization is its professional staff. Since consultants are in the business of selling their experience and expertise, the quality of a counseling firm is related to the abilities of its employees. Thus attracting, motivating and holding strong professional associates are key objectives of a counseling organization.

Over the years, I have developed the following organizational and employment philosophies to sustain my staff.

Total Client Contact

From day one, a consultant should work directly with the client, attending all meetings and presentations, participating in the development of data and conclusions and seeing assignments through to their finish. If a new consultant is relegated to a backroom existence grinding out portions of reports, he/she misses the experience

gained from client interaction and never appreciates the full impact of the assignment.

Eliminate Organizational Chart Stagnation

A complicated organizational structure with an elaborate chain of associates, supervisors, managers, partners, etc. is unnecessary, unproductive and expensive. Each starting associate should work under the close direction of an experienced associate and progress quickly to an autonomous standing which entails complete assignment responsibility subject only to upper-level review. Consultants need to feel they are working for the client rather than a firm or a supervisor.

If You Know Where You Are Going, You Will Get There Faster

Associates hired by HVS, regardless of background and experience, start with the same compensation of salary, percentage of gross billings, selling incentive and profit sharing and they are informed about their maximum compensation level. The time it takes to go from the starting compensation to the maximum level is based solely on ability and effort.

Timesheets Are Not Required If You Are Getting A Piece Of The Action

Everyone within a consulting organization should receive, as part or all of his/her compensation, a percentage of the professional fee collected. Associates, editors and production personnel show a high level of motivation and devotion when their paychecks directly reflect the amount and quality of their individual production.

In addition to compensating pure output, the remuneration formula also should reward continuing education and development of personnel expertise. Supervision, time sheets and time clocks can be eliminated if people are paid on production, effort and expertise rather than time.

Reward New Business Development

All members of a consulting organization actively should participate in new business development. Even junior associates ought to be encouraged to seek out potential clients and market the firm's services. Involvement in professional and trade organizations along with contributions to literature and educational activities are excellent means of generating client exposure, firm recognition and new business.

As with output compensation, associates should receive direct benefits based on a percentage of the new business they create as well as repeat business from satisfied clients. When everyone has a financial interest in new business development and repeat client incentive, the firm benefits from continuous growth.

Eliminate The Yearly Compensation Review

Increased compensation should be based on an individual's ability to perform assignments competently and

independently, along with his/her success in creating new business. Raises must come continuously as the associate moves toward these goals rather than at specific dates or points in time. The elimination of a managerial hierarchy allows the associate to progress to a level of autonomy and monetary compensation based solely on ability rather than time in grade or office policy and politics.

Professional Designation

Many consultants leave the field with nothing to show but experience. By providing the opportunity and incentive to secure a professional designation—CRE, MAI, SREA, CPA—a consulting firm offers its staff a tangible asset that has lifetime value.

Publish And Prosper

A consultant is in the business of selling credibility. All the associates who participate in an assignment should be acknowledged by personally signing the finished report. Encouraging an associate to publish and lecture under his/her own name rather than ghost writing for the boss, aids in developing professional recognition and individual identity.

Flexibility And Freedom

A professional consultant should be treated as a professional. Hours, schedules and vacations remain with the individual. As long as the flow of work is maintained, it makes little difference whether office hours commence at 9:00 am or 3:30 pm.

Using the preceding organizational and employment philosophies as goals—the following employment structure was developed for HVS.

Compensation

All HVS associates receive a starting salary of \$210 per week plus 5% of their gross billings. This should equate to approximately \$20,000 of combined compensation if this level was maintained during the first year. As the associate gains skills and demonstrates an ability to work independently, the salary plus commission increases as follows:

Level	Salary Per Week	Percentage of Gross Billings
1	\$210	5%
2	220	7
3	230	9
4	250	11
5	250	14
6	Draw	25
7	Draw	30
8	Draw	35
9	Draw	40

Performance reviews are made on an ongoing basis and most new associates progress to level three by the end of their first year.

When an associate reaches level six, the salary is re-

placed by a \$20,000 per year draw against a straight commission of 25% of gross billings. The maximum commission level is 40%.

Promotions through level five are based on general ability and effort. Promotion to level six through nine not only requires the associate to demonstrate greater ability and continued effort, but also passage of specific MAI courses and requirements as well as achieving certain levels of new business development. The following table outlines the additional requirements for advancement into levels six through nine.

TABLE
Specific Requirements for Advancement Into Levels 6-9

Level	MAI Requirements	New Business Development Requirements
6	Completion of Courses 1A1, 1A2, 1BA, 1BB, 2-1, 2-2	None
7	Completion of all courses	10% selling for last 12 months equal 10% of the average associate volume per person
8	Demonstrate Appraisal Accepted	10% selling for last 12 months equals 25% of the average associate volume per person
9	MAI Designation Received	10% selling for last 12 months equals 50% of the average associate volume per person

The primary purpose of these specific requirements is to provide the incentive to rapidly complete the course work and demonstration appraisal for the MAI designation. Since the business of HVS is heavily oriented around market studies and appraisals, the educational and experience requirements leading to the MAI are well-suited for our new associates.

The new business development requirements provide an incentive to create new clients for the firm. The term "10% selling" will be more fully explained but for now can be defined as the new business generated by the individual and personal effort of an associate. To reach level seven an associate must have created in the past 12 months new 10% business equal to 10% of the average associate volume per person. For example, if the average associate within the firm works on \$180,000 of assignments per year, then the new business requirement for level seven would be \$18,000 (level eight—\$45,000 level nine—\$90,000).

Editors are compensation based on a starting salary of \$210 per week plus 1½% of their gross billings. During a 12-month period an editor should work on approximately \$600,000 worth of assignments. As their editing skills improve, their salary moves up to \$300 per week and their commission increases to 3%.

Production assistants receive a salary of \$180 per week plus .5% (.005) of their total gross billings.

Selling Commissions

New business development and client satisfaction incentive is provided by two types of selling commissions. Associates receive a 5% selling commission for any new business they create from a previous client. This type of commission is the client satisfaction incentive. By performing superior work and maintaining close client contact, associates are rewarded when a satisfied client calls them with new business. Associates also receive a 5% selling commission for any new business referred to them by the firm. For example, each day an associate is assigned to "associate of the day" (AOD). Any phone calls requesting information about the firm, its services or general questions pertaining to hotel valuations and market studies are handled by the AOD. If one of these phone calls results in an assignment, the AOD is entitled to a 5% selling commission.

Associates earning a 5% selling commission have the option of either working on the assignment themselves or turning it over to another associate.

A 10% selling commission is paid to associates who develop new clients for the firm. To receive a 10% commission, the associate must demonstrate that it was his/her individual and personal effort which brought the new client to HVS. Once an associate creates a 10% client, he/she is entitled to receive selling commissions from all future business generated by this client. If, however, another associate sells a future assignment to this client, the 10% associate will relinquish 5% of the commission to the selling associate. This procedure maintains the client satisfaction incentive while capping the firm's selling expense at 10%.

Subcontracting

The real incentive offered by HVS for new business development is subcontracting. When an associate sells a 10% assignment he/she may either work on the assignment and receive the appropriate percentage of gross billing level or subcontract the work to another associate and make the spread between the amount he/she would receive from the percentage of gross billing level and the actual cost to the firm to have the other associate work on the assignment. The economics of subcontracting can be illustrated with the following:

Example:

Associate A sells a \$20,000 appraisal to a new client he met while attending an appraisal course. Associate A is currently at level seven making a draw against 30% of the gross billing. Since this client represents a 10% selling commission, Associate A decides to subcontract the assignment to Associate B, who is at level two earning \$220 per week plus 7% of the gross billings. Associate B works on the assignment under the direction of Associate A and devotes a total of 20 days to the project. Associate A visits the subject property, assists in the

analysis, meets with the client and spends a total of four days on the assignment.

The following table sets forth the compensation of both Associate A and B.

<i>Associate B</i>	
Commission (\$20,000 x .07)	\$1,400
Salary (\$220 x 4)	880
Payroll Taxes and Benefits	279
Medical Insurance	<u>75</u>
Total Compensation	\$2,634
<i>Associate A</i>	
Commission—Selling (\$20,000 x .10)	\$2,000
Commission—Work (\$20,000 x .30)	<u>6,000</u>
Total	\$8,000
Less: Associate B Compensation	<u>2,634</u>
Net to Associate A	\$5,366

This example demonstrates that by subcontracting, Associate A is able to spend only four days on this assignment and net \$5,366 or \$1,341 per day as compared to doing the complete assignment over 20 days and earning the full \$8000 commission or \$400 per day.

The ability of an associate to create and personally service any new business through the process of subcontracting is essentially the same as having your own business without the overhead of maintaining a staff. Subcontracting follows the same principle as leveraging real estate and it creates a highly motivated entrepreneurial spirit within the organization.

Profit Sharing Plan

HVS has a profit sharing and retirement plan for all full time employees who meet the eligibility requirements. Under the plan, the firm contributes a minimum of 10% and a maximum of 25% of each employee's total earnings. These tax free contributions are managed by the plan administrator and compound tax free until withdrawn upon retirement.

An average associate should accumulate approximately \$135,000 in the profit sharing plan within five years of eligibility. To date HVS always has contributed the full 25% to the profit sharing plan. Because of the tax shelter benefits, a profit sharing plan has significant value to high income employees.

The Maximum Commission Level

The top commission level of 40% has been established because it represents the approximate level at which the firm breaks, even on an assignment. The following chart shows this calculation:

	Percentage of Total Fee
Maximum Associate Commission	40%
Selling Commission	10
Editor Commission	3
Editor Salary	<u>2</u>
Total	55.00%

Profit Sharing (25% x 55%)	13.75
Payroll Taxes (10% x 55%)	5.55
Total	74.30%

Assuming an associate is at the 40% level, approximately 75% of the total fee is paid out to both the associate and editor in the form of salaries, commissions, profit sharing and payroll taxes. The 25% remaining must cover all overhead expenses such as medical insurance, office supplies, computers and equipment, telephone, rent, etc.

This calculation demonstrates that assignments performed by 40% associates generate little or no profit for the firm. By paying these top associates literally all of the consulting fee available for professional salaries, HVS is attempting to eliminate the financial benefits for an associate to leave and set up a competing practice. I want associates to make more money and work on more interesting assignments with HVS than they can do either on their own or with another firm.

Flexible Work Hours

HVS operates 24 hours a day—seven days per week. Editors and production assistants must work 40 hours each week but their schedule is totally flexible. Associates also may come and go as they wish as long as the work is completed on time.

Regional Offices

The ultimate goal of any consultant is to become a partner of the firm. In most organizations, a partnership interest consists of a small piece of a large pie (i.e. the firm's equity is split amongst many partners). This philosophy runs counter to the HVS entrepreneurial goals of compensating associates for their direct and personal contributions rather than having an ownership structure where individual efforts cannot be identified from the mass of other partners. As a result, HVS provides its associates with an opportunity to obtain a large piece of a small pie in the form of a 50% ownership interest in a regional office.

Once an HVS associate receives the MAI designation, he/she is eligible to open a regional office. The ownership of the regional office is split 50%-50% between the associate and Hospitality Valuation Services, Inc.-New York (HVS-NY). The associate contributes the sweat equity needed to start the office and develop new business. HVS-NY lends all opening and operating capital and directs business to the regional office. The commission structure is identical to that of HVS-NY (described previously) with the associate partner also receiving 50% of

the bottom line profit plus the residual ownership value created in the regional office. Since the personal and individual effort involved with generating revenue and controlling expenses will benefit a 50% partner in a small firm more than say a 5% partner of a large firm, this ownership structure increases the performance incentive.

New associates hired by a regional office will have the same opportunity to progress to an ownership position. Upon obtaining their MAI designation, they can open a subregional office as a 50% partner with HVS-NY and the partner of the regional office each having a 25% interest.

Conclusion

The compensation structure of HVS was devised to reward entrepreneurial effort. Responsibility for increased remuneration is therefore in the total control of the individual associate. While some people like to become last in the crowd, where their individual efforts (or lack thereof) cannot be directly measured, these types of employees generally do not have the proper motivation to be successful consultants.

The HVS organizational structure functions reasonably well, but I would be remiss not to also point out some of its possible shortcomings:

- Defining whether a sales commission represents a 5% or 10% client is sometimes difficult to determine as is which associate was actually responsible for bringing the new business to the firm.
- As associates become successful in creating new business, the firm must hire more new associates so the selling associate can make a profit by subcontracting. This system rewards and perpetuates growth which means the organization will never remain small.
- Since the firm essentially breaks even on 40% associates, there is more incentive to assign the firm generated business to lower level associates. High level associates must therefore create a sufficient amount of 10% business to justify their level of compensation.
- The bookkeeping involved with keeping track of everyone's salary and commission is horrendous.

Hopefully this discussion of the HVS compensation program will interest other consultants to reveal their organizational and compensation structures. By exchanging ideas and operating experiences relating to our practices, we should all benefit.