



Bulletin:

Setting Your Rates

By James R. Ziegler, Ph.D.

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Rate Surveys.

Finding rates online.

A good place to find contractor's rates is Janet Ruhl's Real Rates web site at <http://www.realrates.com>. Actually, Janet posts both hourly rates and annual salaries submitted by actual workers. This makes these rates, I believe, more reliable than rates submitted by recruiting firms that are likely to report hourly pay rates instead of actual client billing rates.

The Real Rates analysis shows that over all types of IT jobs the median salary for permanent workers was \$62,000. For temporary workers it was \$71,000.

The median billing rate for unbrokered independent contractors was \$75 per hour.

This shows that overall hourly billing rates are slightly higher than 1/1000th of annual salaries.

Divide-by-1000 rule of thumb.

There is a universal rule of thumb that links hourly billing rates to annual salaries. It is called the "divide-by-1000" rule of thumb. Essentially, you divide the annual salary of an individual with a particular skill set and level of experience by 1000 to obtain the equivalent hourly billing rate that an

unbrokered, independent contractor must charge to break even with the total compensation package of a salaried employee.

I have casually tested this rule by comparing average annual salaries versus average billing rates for unbrokered independent contractors using data posted on Janet Ruhl's Real Rates Web Site at www.realrates.com.

Here are some examples. I mixed and matched states to get at least 10 in a sample.

Tech Writer (all locations)

Average Salary (12): \$62,933

Average Billing (15): \$64.27

Sr. Programmer (California)

Average Salary (12): \$74,783

Average Billing (42): \$91.40

DBA (California and Florida)

Average Salary (15): \$83,867

Average Billing (6): \$143.83

Network Engineer (California, Texas, and New York)

Average Salary (17): \$60,824

Average Billing (6): \$60.60

Clearly, contract Sr. Programmers and DBAs can bill more than the divide-by-1000 rule of thumb would indicate, while Tech Writers and Network Engineers are right on the money using this technique.

Unbiased contract billing rates are hard to come by because most of the published surveys (e.g., Dice.com, etc.) are posted by agencies that tend to post hourly pay rates as opposed to hourly billing rates. Outside recruiters are trained negotiators, and they are able to obtain higher billing rates than can unbrokered independent contractors. But higher billing rates negotiated by outside recruiters do not begin to compensate for the high margins extracted by contractor recruiting firms.

Converting agency pay rates to billing rates.

Janet Ruhl's data show that across all job types, brokered contractors earn \$60 per hour whereas unbrokered contractors earn \$75 per hour. Her data further shows that for W-2 contractors the agency take is an average of 33% of the billing rate.

Thus, if you want to know what is the billing rate for a specific skill set you are advised to divide the rates in agency sponsored rate surveys by $1 - .33 = 67\%$. For example, if the rate survey says that the rate for a Java programmer is \$60 per hour, the actual billing rate is likely to be closer to $\$60 / .67 = \90 per hour.

Keep this in mind when you read any rate survey sponsored by recruiting firms and the job boards that sell resumes to them (e.g., Dice.com and Contract Professional Magazine).

Why the divide-by-1000 rule of thumb works.

The divide-by-1000 rule actually has a strong basis in fact, and it is supported by the marketplace regardless of job title or geographic location.

The underlying basis is this: Take the total, fully-loaded, labor cost per year for a full-time salaried employee and divide by the actual number of hours a typical full-time

employee works in a year. Then you add a little profit and additional compensation for the risk of being temporary instead of full time.

Here is an example:

Annual Salary = \$100,000

Labor Load = 40% or \$40,000

The annual salary may also be augmented by performance bonuses, so let's add an additional 10%.

10% performance bonus = \$10,000

Fully-loaded labor cost = \$150,000.

The Labor Load is the actual cost of the employer's share of payroll taxes, benefits, retirement contributions, administrative overhead to support the employee, insurance costs, cubicle rental and related costs, computer costs and maintenance, software licenses, training costs, travel expenses, and perks. It can easily exceed 40% of base annual salary.

The actual number of hours a contractor can bill is up to the individual, but most full-time employees only work about 1700 hours per year. For example:

Vacation: 3 weeks (or more)

Sick/personal days: 2 weeks

National holidays: 2 weeks

On the job training: 2 weeks (or more)

Total time off: 9 weeks

Contractors frequently have unexpected unbillable time off when they are marketing themselves to clients, so add an additional 1 to 3 weeks of down time. Let's call it 2 weeks.

Total time off for contractor: 11 weeks

Total billable hours: 52 weeks - 11 weeks = 41 weeks * 40 hours/week = 1640 hours.

Now, let's do the arithmetic.

Total annual compensation

divided by

Total billable hours in a year

equals equivalent hourly billing rate.

$\$150,000 / 1640 \text{ hours} = \91.46 per hour

Inflate this rate to allow for an employer of record's service fee (P.A.C.E. charges 5%) and add a little profit and you have an hourly billing rate that is approximately 1/1000 of the annual salary.

You can find many more salary surveys on the web than hourly contract rate surveys. And the annual salaries are likely to be less biased by the influence of greedy contract brokers.

Here is how easy it is to find salary information online. You will be overwhelmed by the number of salary surveys on the web. Just go to <http://www.altavista.com> or <http://www.google.com> or any of the other search engines and enter the keywords <salary survey>. You can also enter <rate survey>

Alta Vista returned 54K web pages that mention salary survey, and Google returned 34K pages.

You can narrow down the search by inserting additional keywords such as <IT> <technical> <computer> <software> <electrical engineer> etc.

Now that you have a boatload of salary surveys, some up to a year old, you can inflate them by about 25%, which is the amount that high tech salaries increased over the past year, and divide by 1000. This will put you squarely in the ballpark for an equivalent hourly billing rate.

The rule of thumb also works in the opposite direction. Suppose that your billing rate as an unbrokered independent contractor is \$100 per hour. A company would have to offer you an annual salary of at least \$100,000 to induce you to become a permanent employee.

Use the divide-by-1000 rule of thumb to convert “permanent” jobs to contract assignments.

Here is another twist on the same theme. By adeptly applying the divide-by-1000 rule of thumb contractors can actually apply for a permanent position, yet be hired as a high-paid contractor. This is important because there are currently 1.6 million unfilled high tech jobs being offered by non-governmental, for-profit companies with more than 50 employees. It is expected that half will never be filled.

Many companies still have a bias for permanent employees. As a contractor your challenge is to give these companies a reason to view you as a candidate for the permanent position they are looking to fill.

Here is the drill. Apply directly for an advertised permanent job, or just call HR out of the blue to see if they need someone with your skill set. If they tell you they are looking to fill a particular permanent position ask them what is the salary range. Suppose the HR person tells you it is \$75,000 to \$85,000 depending on experience. Voila! You now know that the equivalent hourly billing rate for the position is \$85 per hour.

Now explain that you have been working as a contractor, but that you are available immediately to fill a temp-to-perm position. Temp-to-perm would give the company the ability to evaluate you and give you the ability to evaluate the company. And, best of all, you don't have to give notice since you are available immediately. Also, because of your broad experience as a contractor you can hit the boards running. You are the bromide that will ease their pain.

This approach lets the company evaluate you as a potential fulltime employee, which is just what they are looking for. You flew in and landed right in their lap, and they'll jump at the opportunity to hire you if they know what is good for them. Besides, what you are asking as a billing rate is close to the fully loaded labor cost, so it is a breakeven situation all the way around.

Of course, you don't ever have to convert to full time, but if you do convert you are already poised for the top of the salary range. The company is unlikely to replace you with a permanent employee because you are a "known quantity", and replacing you with an unknown would be risky at best.