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Is a "Blended Rate" for Consulting Services Good for Customers?

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Many are familiar with the notion of a "blended rate" in the consulting services and software implementation business. Consultants are smart, and the term "blended" itself was a good choice, as it connotes something smooth and easily digestible.

In any case, recently someone asked me my opinion of the rate that they were getting on implementation resources from an ERP provider. They felt good because they believed the blended rate they had negotiated was attractive. Should they be happy?

A blended rate is the way an increasing number of consultants and implementers quote out their resources. On almost all projects, there are resources of different levels and skills, with different internal costs and standard billing rates for their time. Rather than bill each of these resources individually at their respective rates, the consultant creates something that looks like average hourly rate for that pool of resources – the blended rate. Each hour worked is billed at that blended rate, regardless of the actual rate or experience of the resource. Blended rates are therefore an easy and convenient way for consultants to come up with a single, simple number to present to the clients in pitching the business and in subsequent billings for the project. Customers tend to like this too since it is simpler than the alternative, and they believe they can do more of an *apple-to-apples* comparison of numbers that way.

A more specific example would be something like this: assume the project team is made up seven team members. A team this size will usually have a senior consultant, one or two second in commands, and the rest implementers, or "doers." Whether or not you are paying more for anyone else on this project, like a higher level partner or even "project manager" with part-time attention to the effort, the senior consultant is the most important resource to you. Then there are the "seconds". These resources will become the senior consultants sometime in the near future. These are the next most important resources on the project.

So here is how this might be pitched: "Look," they say, "normally we bill out the senior consultant for $215 per hour, these two others for $205, and the rest at $185. Let's just do a blended rate of $195." This all seems pretty fair, right? Actually, here is what's happening. You are getting a great rate on the senior consultant and the seconds. The senior consultant is probably producing $300 per hour of real value on this job, and the seconds may not be far behind – let's say $225-250 per hour of real value.

But what about the doers? Well, there's the rub. The skill level, and cost, of these resources varies wildly. It is very conceivable that you could be looking at a person right out of college making $50K or less per year, or a foreign national making a lot less than that. The true project value-add for these resources may be somewhat under $100 per hour – perhaps as low as $75 per hour for these, often, highly commoditized resources. Using $100 per hour for the doers and using my potentially controversial theory that the senior resources true value to the project is greater than their published rate, the math becomes:

- $300 per hour for the senior consultant
- $250 per hour for the two seconds
- $100 per hour for the four "doers"

This results in an average rate of $171 per hour. On a medium size or larger project, that $24 per hour difference in rate can be a significant bit of money. Still, that may not be the biggest issue facing you in a blended rate situation. Blended rates create an inherent incentive for the vendor to minimize your use of the more expensive resources. Obviously, the more they can use their lower cost/higher margin resources – the larger the project profit. But more importantly to the vendor, because the senior resource is one of the primary leverage points they have, they tend to be a considerable driver of revenue. By selling one of them into a job, they can leverage X more, less expensive resources. Unfortunately, due to the relative rarity of real talent at this level, they cannot always be placed exclusively on one project. This creates another, potentially more pressing, incentive to minimize the senior consultant's involvement.

How to get the best for your money? Frankly, whenever possible do not use blended rates. Yes, it's not as simple, and will add a little work on the project management side of things to manage the invoices, but the rewards will be well worth it. It simply puts you in much better control.

Should you be in a situation where you can't avoid a blended rate, or really prefer the simplicity even at the cost of less financial and project control, be aggressive in your negotiations. Calculate the true value each level of resource adds and calculate your own blended rate based on paying more for critical resources, and much, much less for commoditized ones. Use this as your starting point for negotiations. More specific tips include:

- Estimate the total cost/value equation using a model like that described above, and negotiate the blended rate based on that economic model, not just some average of the different rate levels.
- Interview all project team members and make sure your contract gives you the ability to refuse candidates – but be reasonable
- If offshore staff is being used, recognize that costs for the consultant are likely very low, and profit margins very high
- Force the consultant to give you allocation estimates upon which the blended rate is based: look for fairness in the subsequent blended rate, and ask for hours expended by level throughout the project to ensure the estimate and reality are in synch
- Make sure your senior consultant is committed to your job. The senior consultant is the most important resource and can make or break a project – also making them among the most valuable resources the vendor has - don't share him/her. Still, there may be some pressure to pull your senior resources off for "just a few days" (especially if you have strong seconds). Cover this in the contract by either altering the blended rate accordingly (only if you have strong seconds), or having the ability to stop that from happening all together
- Get some of your own doers. If the project can support it, you may want to think about controlling some of the doers yourself. After the defined project scope is done, there is always plenty to do for a good period of time – you will reap significant savings by having qualified resources under your direct control after the official project is completed
- Finally, nothing is better than detailed involvement and good project management on the customer's side. Hold your vendor accountable for their commitments and likewise uphold yours.

Remember, there must be a reason vendors like the blended rate. As Webster's Dictionary says – to blend is to "to reduce the particles so that they are uniformly small and evenly distributed." In many cases, it's the vendor's talent pool that is the thing getting reduced to uniformly small particles and distributed. Be willing to pay for real talent and avoid the blended rate where you can. If you can't avoid it, be aggressive in your negotiations and make the blended rate work for you by gaining control of the resource equation.

About the Author

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