CONTRACTING DECODED: RUNNING A SUCCESSFUL CONTRACT RECRUITING BUSINESS

Learn the ins and outs of contract recruiting & start making more money today!

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Contracting Decoded: Running a Successful Contract Recruiting Business

Introduction

In the past, the idea of a small firm or independent recruiter being able to handle temp/contract needs seemed impossible. With resources, monetary constraints, and overall capabilities to consider, contract recruiting seemed to be a landscape only larger firms were equipped to navigate.

Now, with nearly a third of the U.S. workforce shifting to contingent roles by 2026, it's clear the evolving workforce is moving away from the status quo in favor of other perks, including more flexibility and variety. Further, given the drastic evolution of the industry and the growing demand for temporary workers, contract recruiting is ultimately a lot easier to offer.

If you're looking to experience results (including earning an average of $15,000/year for every temp/contract worker you place, creating new revenues streams from the same work you've already done, or possibly selling your business one day for a real profit), this eBook can help take the mystery out of the contract recruiting business, while also helping existing contracting/staffing business reach new levels!

Keeping It Simple

(This section is specific to those who are looking to start a contract recruiting business. If you already have one, feel free to skip to the next section, "Building a Payroll Business.")

Although placing contract is not as straight-forward as hiring full-time employees (FTE), contract recruiting does not have to be overly complicated.

One hesitation recruiters often have is that they don't feel like it will pay as much as FTE. Search, as you know, is 100 percent margin; so in other words, you receive 100 percent gross profit (minus commission, but that's considered a "below the line" expense). In reality, contracting is really pretty similar, but you have more opportunities to earn on your placement (e.g. hourly, weekly, monthly, quarterly, etc.). Also since you have to pay wages, your gross profit is simply your sales minus your costs.

Here are a few terms to keep in mind when first navigating all of the numbers surrounding contract recruiting:

Burden

Burden (also sometimes referred to as "pay charges") are the costs you will incur above and beyond the pay rate that you choose. These include workers' compensation insurance, as well as all applicable federal, state, and local taxes and withholdings. This is shown as a percentage of the contractor's base pay, and will vary based upon the position location (due to varying state withholdings) and workers' compensation position code (due to varying risks and claims).

The 3 ways to determine your gross margin include:

1. Bill Rate - Pay Rate - Payroll Burdens = Gross Margin/hour
2. Total Invoice – Wages (Pay) - Payroll Burdens = Total Gross Margin
3. Total Invoice less (Pay) * (1+burden%) less (Pay) * (1+Service Fee%) = Total Gross Margin†

†*Burden is shown as a % of pay rate.*

Markup

Markup is determined by dividing the bill rate by the pay rate, and the subtracting by one. It is important to note that the markup calculation does not take into account any burden rates; however, it should be sufficient enough to cover all cost associated with the payroll, plus provide an acceptable profit.

For example, if you have an hourly pay rate of $30/hour and you bill $45/hour, you will have a 50 percent markup; similarly, a 75 percent markup would yield a $52.50 bill rate and a 100 percent markup would yield a $60 bill rate. This is typically expressed as 1.50, 1.75 or 2.0 times the pay rate.

Margin

Your margin (or gross margin) is directly related to markup, and reflects your real gross profit! Margin accounts for your billings less your wages, burden, and any other direct payroll costs. Your gross margin percentage is one way that you should measure any opportunity and your overall business, given it more accurately reflects your profit than markup does.

Gross margin percent is simply the percentage of your sales dollars that will become gross profit (i.e. the profit that will be yours to help pay for everything else in your business—any overhead, salaries, tools, etc.). To determine this percentage for contracting, you simply take your gross margin dollars and divide that by your sales; similarly, you can take your hourly pay rate, adjust it to include the burden and fees, and then divide by your hourly bill rate, and subtract by one.

Once you know this percentage, you can then multiply it by any projected sales dollars to forecast your exact profit! This becomes extremely important when determining how to price contract, offer discounts, hit certain sales goals, and project further profit should an assignment convert to a permanent role.

Working Example

Say you had the following:

- Bill rate = $45
- Pay rate = $30
- Markup = 50 percent
- Burden = 15 percent (no service fees)

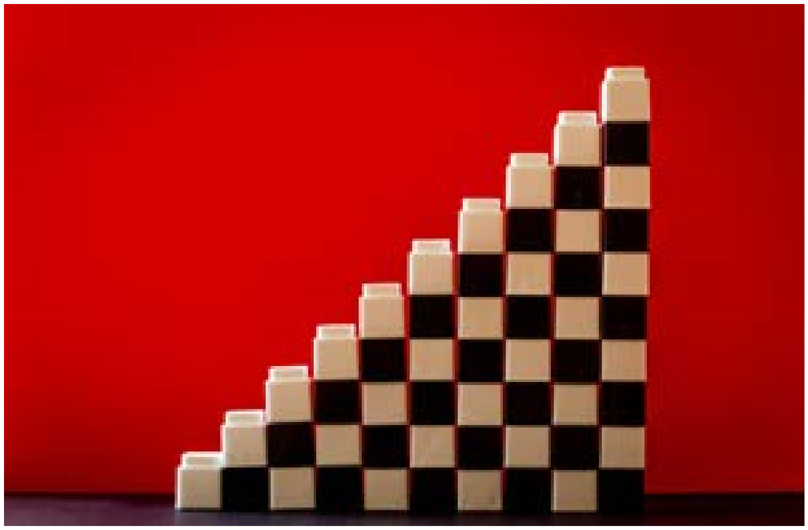
To determine gross profit, multiply the pay rate by the burden percentage (30 x .15 = 4.5), add that number back into the pay rate (30 + 4.5), and then subtract from the bill rate (45 – 34.50). In this instance, you would make $10.50 an hour in gross profit. To figure out your gross profit margin, simply take your gross profit and divide it by the bill rate. In this example, $10.50/$45 = 23.33 percent. Meaning, you will have a gross profit of roughly $.23 for every $1 you bill (and $23.33 per every $100)!

To give a better view into the long-term gain that contract placements can provide, say you have a temp worker on a three-month, full-time assignment. If you take the amount you're billing them (520 hours at $45/hr.) and multiply that by your gross profit margin (.2333), you end up making nearly $5,460 dollars. Extend that to a year-long assignment, and one contractor could end up providing you with more than $22,000 in extra earnings!

However, it's important to note that this example assumes you are the employer of record (EOR), and does not take into account any other funding fees, costs, or incurred services. A full-service EOR can take on contract workers you place as their own employees, while handling all the administrative tasks of onboarding, time collections, payroll, invoicing, and credit and collections for a nominal percentage of your payroll (more details on EOR capabilities will be discussed throughout the eBook).

Building a Payroll Business

Before clients begin calling you for their contract-placement needs, it's important that you have all of your ducks in a row to ensure that your business operations run smoothly.



Bear in mind, most of these aspects of the contract recruiting business can be very time-consuming, and will certainly derail you from your sales efforts. Given many firms are intimidated by the risk associated with the regulatory and compliance requirements of being the EOR, as well as needing sufficient working capital to cover the up-front costs and fees and the frustration and anxiety that naturally comes when implementing this type of business, third-party vendors are often utilized.

Either way, it's important to understand the following elements of contract recruiting to help you make the best decision for your business:

Employer of Record

By taking on contract recruiting, you will need to become the legal employer of record (EOR) for your temp and contract employees. This means that any workers you place will legally become your employee and responsibility (e.g. making sure they're paid, properly classified, receive benefits, etc.).

Given that serving as the EOR can make you legally vulnerable, a good best practice is to create a new corporation (e.g. LLC or S-Corp) solely dedicated to this side of your business. That way, in the event that something was to happen (e.g. a lawsuit brought against you or your employee), your direct-hire business or other personal assets are not also attacked.

Insurance and Licenses

As an EOR, you will need to carry the appropriate insurances and licenses, as required by law. In addition to general liability insurance, you will also be required to carry workers' compensation insurance for each state you place workers, as well as be registered there. Further, it is recommended that you also buy an umbrella policy, auto coverage, errors and omissions insurance, and criminal insurance. Very often, your clients will have very specific additional insurance requirements.

Recommended insurance coverage for your contract-recruiting business:

- Statutory Workers' Compensation Insurance ($1,000,000 per accident)
- Crime insurance (minimum $50,000, up to $100,000 depending on the criminal act)
- Hired and Non-Hired Automobile Liability ($1,000,000 combined single limits)
- International Travel Workers' Compensation Insurance ($1,000,000 per accident, $2,000,000 in the aggregate) if employees will be traveling outside the U.S.
- Commercial Liability Insurance ($1,000,000 per occurrence, $2,000,000 in the aggregate)
- Professional Liability ($1,000,000 combined single limits, $2,500 deductible)
- Commercial Excess Liability/ Umbrella ($5,000,000 per occurrence, $5,000,000 in the aggregate)

Workers' Compensation

Looking further into workers' compensation insurance, it's important to recognize that every state has its own requirements. While your insurance agent can handle most states, there are a handful of monopolistic states that require you to personal acquire workers' compensation coverage through the state (e.g. Ohio, Washington, North Dakota, and Wyoming).

What's more, with smaller firms without huge volumes, you will be required to pay all premiums up front or submit a sizable deposit. Your broker (and the states listed above) will determine your existing and projected pay/wages volume, and then apply standard rates and an experience modifier based upon the workers' compensation codes (skill codes) that you expect to fill. You will only be covered for the codes that you obtain prior approval for and pay for.

Further, additional binding can be underwritten (usually within 48 hours of notice), but given that might be too long for a quick assignment that you could lose out on to a competitor, you are better off overpaying the premium and getting the binding for what you need. However, most monopoly states will require actual job descriptions and details, and won't bind you until you get the actual job.

Bear in mind that since all workers' compensation is based upon "estimated pay," premiums are simply estimates. Each year, your insurance carrier will look at the estimated wages versus the actual ones, and then issues a surcharge or credit for the premium that you should have paid. If additional premiums are due, payment will be required prior to your next renewal. Your new premiums will now include your actual claims experience (losses paid out due to employee injuries) from the prior year, which could reduce or increase your cost for the new year.

Front-Office/Applicant Tracking System

If the goal is to grow your business beyond a small sole proprietor or search business, this type of technology will help facilitate a successful contract recruiting business. Although sufficient in the early stages, it is highly recommended you don't rely on Excel, Outlook, or other antiquated modes of tracking data and relationships. Luckily, there are several high-quality, easy-to-use independent systems on the market to choose from to best fit your business' needs and get up and running quickly!

As such, make sure you go with a web-based system that requires no server and operates via the cloud. Additionally, your system must be setup to allow for the placement of temporary and contract workers. Some of the industry's top systems are available for as little as $150/month.

Time Cards and Payroll Processing

It is also necessary to make sure time and payroll are appropriately tracked and managed. As such, you will need to provide time cards for your candidates to submit and clients to approve. To ensure they are filled out properly and on-time, it is strongly suggested that you purchase the ability to process time cards electronically via a web portal or email.

What's more, you will need a company that can process your payroll for you. They will take care of all of your necessary withholdings, file your taxes, pay your contractors, and provide them with their W2s. This can be as simple as using a payroll company, like ADP, or someone much more advanced and experienced managing the intricacies of temporary payroll. However, due to the complexities associated with processing payroll compliantly (and the massive associated legal risk with this), it is recommended that you partner with a company that can eliminate the risk of you being hit with large penalties for incorrect withholdings, classifications, or payments.

Credit, Collections, and Funding

Unlike perm hiring, the contract recruiting world requires you to front payroll and payroll taxes each week that a contractor works. That means if you're offering your clients 30-day payment terms, you are fronting the cost of four weeks of payroll costs before you see any money back from them. If your client ends or defaults for any reasons (e.g. claims against the employee, insolvency/bankruptcy, can't get ahold of them, etc.), you could be left holding the bag. Therefore, it's important to have a good credit system in place, like Dun & Bradstreet, Experian, Credit Safe, or Lexus Nexus.

What's more, since you will be responsible for pre-funding wages and payroll costs, you want to make sure that you collect cash on a timely basis. While self-funding might seem plausible, the reality is most recruiting firms notoriously underestimate the working capital requirements necessary. To avoid cash flow issues where your receipts are not meeting the demands of the day-today operating cost and funding new growth of your business, it's important to have some sort of credit facility.

As such, here are a few options to consider :

- **Line of credit**: This is the preferred means of managing the ebbs and flows of the cash on hand (collection), versus the wages or operational expenses needed to meet the obligations of the business. Typically, this type of arrangement is through a financial institution, and requires a certain amount of underwriting and personal guarantees. Further, cash available is tied to a percentage of your overall outstanding invoices. As new invoices are generated and payments are received, you are able to draw down cash, as needed, up to an agreed amount of the total outstanding receivables (e.g. 85 percent to 95 percent). Some additional restrictions apply, based upon the individual lender.
- **Factoring**: While factoring is a very common solution in the industry for small- and medium-sized firms, it is more expensive. However, it can be easier than working with a bank, particularly in an environment where banks are extremely cautious to lend and there are few alternatives available. With this option, you're essentially selling your accounts receivable to a third party at a steep discount on the value of your receivables, while the factor assumes responsibility for collecting the outstanding receivables amounts. Agreements with factors vary widely, as do the formulas they use to determine the value of your receivables; but generally, a factor will advance you a percentage of your accounts receivables up front. From there, you may receive an additional portion in cash later, depending on the level of success the factor has with collections. In the end, extra precaution needs to be taken when dealing with factors.
- **Full-service funding**: In addition to payroll funding, this method provides a wide range of services. This working-capital option typically costs a new or small firm around three to five percent of total invoices, while the funding company provides additional services to help you manage your business (e.g. credit and collections, payroll processing, reporting, etc.).

FUNDING

- ✓ Enables you to pay workers on time/ correctly & maintain a positive brand imagine in your market.
- ✓ Often comes bundled with other services to benefit your organization (e.g. back-office technology/resources, risk management, consultation, etc.).
- ✓ Able to provide lower rates, given not all income is generated from funding fees alone via bundling.
- ✓ Allows you to offload non-core, administrative functions — saving money & increasing overall efficiency.

FACTORING

- ✗ Can go after your personal assets if a customer defaults and you cannot pay back the company in advance.
- ✗ Confusing contract language can mask real costs of facotring, and make it exceedingly difficult to get out of the arranged relationship.
- ✗ Even more expensive than working with a traditional bank—converting fees to an APR, rate can exceed 30%.
- ✗ Funding can be cut off, or higher fees can be applied if company performance suffers.

Positioning Yourself to Clients & Candidates

Once you have the right infrastructure in place, you are ready to start placing contract! But how do you go about marketing your new business venture? And what exactly should you be charging?

For one, now that you're a one-stop shop for all of your clients' recruiting needs (e.g. direct hire and contingent), this vantage point will make you seem larger than you are and hinder your clients from seeking out competitors. Additionally, the hiring rate of contractors on a temp-to-perm basis is significantly higher than the industry's average sendout-to-placement ratio.

Further, you can use your temporary placements to help you place with a company time and time again. Once you have a contractor working for a company, you are more likely to receive permanent placement opportunities; inversely, if you already have direct-hire clients, they will likely be very willing to allow you to fill their contract needs.

Finding New Business

While you can try and leverage your current client base to start your contract-placement business, here are a few strategies for trying to acquire new business while also keeping in mind the specific complexities that come with contract recruiting:

- **Collaboration and split network**: The saying "a little of something is better than a whole lot of nothing," rings true in the recruiting industry. Given the lifecycle of an order significantly decreases in contract recruiting (with several orders sometimes closing in only a few hours), smaller/new firms often struggle with the chicken or the egg syndrome: you get an order, but don't have anyone readily available; or you get a great temp/contractor candidate, but then don't have the right job at the right time. As such, using a split network (via job/candidate sharing portals) is a key way to ensure you serve your clients and maximize your revenue!

- **Skill marketing**: Since the "shelf life" on candidates is much shorter in contract recruiting, it's necessary to have an order ready for any great, unemployed candidate that wants to work in the contract space. Once you have a great candidate, work on carving out avenues to help them find a placement (e.g. create an opening via talking to clients, looking at places where you know there has been similar contract activity, etc.). This will make them more likely to recommend you to other people they know looking for work or return to you after their assignment is finished.
- **Cold calling**: Do you hate calling on job postings as a permanent recruiter? Now that you can place contract, you will look at all job postings in a new way. Calling on postings and selling placements not only gives you the perm-hire order, but also gives you the opportunity to offer to put in a contractor to slow down the backlog while they are searching. This marketing strategy demonstrates that you can provide a solution for any talent-placement problems clients might be having, while earning tens of thousands of dollars!

"Try Before You Buy" Approach

Whether a client is unsure about temporary placements in general, or worried about a specific candidate, positioning your contract recruiting services as a "try before you buy" model can help you overcome obstacles.

Tell your client that you want to approach their search assignments from a pure search and temp-to-perm position, but highlight that the best way to avoid a mis-hire would be to see the person work, instead of just interviewing.

Similarly, if they are worried about a candidate you're proposing for a role (e.g. one that has been out of work for a while), suggesting your client take them on for a trial period can help you salvage a deal you otherwise would have lost.

Leveraging Your Expertise

While you might just be starting contract recruiting, the truth is, you know how to navigate the talent landscape. As such, work this angle to your advantage, and make clients and candidates see you as someone who is guiding them to the best outcome.

One position you can leverage is selling an unemployed candidate to any open job order as a contractor or temp-to-perm. From the candidate's perspective, you're able to get them work right away at a job they might not have gotten otherwise, with the potential for it to turn long-term. From the client's perspective, you are able to show your willingness to put your placement skills to the test via a trial period for the employee (or at least an interview).

What's more, you can also build your permanent hire fees into your contract margin. For example, if you would have settled on a $10,000 permanent placement fee, using the earlier margin/bill-rate example ($45 bill and $30 pay), you can make the same fee after only seven months of contract work! Given you'd be making a better deal this way, you can give the contractor to your client as a free conversion if they last the full one-year assignment, or discount the fees for a shorter timeframe. You will still be making more money than you would with a permanent one-time placement while demonstrating to your client that you appreciate their business.

It is key to point out that you may actually decide to charge a lower total fee (conversion fee plus temp margin) than your standard search fee. This is because your expected value or placement ratio will be significantly higher than if you went the search only route. As such, you will make more money over time by charging less.

Pricing & Payout

In general, to start the money conversation, ask your client what they have budgeted to give you a hopeful starting point. If that's not an option, ask the candidate what they expect to be paid. While they will almost always ask for a bit more than they will actually take, you can talk them down once you find a job that they're really interested in. As a rule of thumb, you will pay them less per hour than they would make working a full-time job, given the nature of contract business (except for IT, engineering, or 1099/corp-to-corp roles).

Once you have your starting point and know what the client will or won't do, you can decide case-by-case whether or not you want to fill a job. In the same margin example earlier, even with a $45 bill rate and a lower 50 percent markup, you will still make a hefty $20,000+ for a one-year assignment! Further, you will make much more if the pay is lower and/or the bill is higher, providing you with complete pricing flexibility.

If you have worked temp/contract before for a corporation or firm, DO NOT bring your pricing habits with you. While you may be used to a base salary and around a 10 percent commission, you can now earn triple or quadruple that! Simply focus on building your temp/contract base, and work on increasing your pricing later. Don't be afraid to eventually ask for higher markups to get to higher bill rates!

A Partner You Can Trust

Now that you have a firm grasp on the ins and outs of placing contract, it's likely that you are excited about the prospect of making more money, but potentially unsure if you can handle all of the intricacies that come with it.

Although starting your own contract recruiting business might seem overwhelming, it doesn't have to be! While a named EOR is necessary for contract recruiting, know that you don't have to take on that responsibility or risk yourself. By engaging a third-party partner, you can avoid various legal risks and back-office burdens, while receiving benefits like payroll, funding, access to experts and training, and much more!

As an EOR, People 2.0 was founded on the belief that recruiters should focus on doing what they do best: growing their business, providing quality customer service, and placing top contract talent for their customers. And with an established record of helping independent recruiters and recruiting firms, People 2.0 can directly handle all of the aspects of contract recruiting discussed throughout this eBook—regardless of whether you're just starting out or have an existing contracting business!

Learn more about how we can help you start your own contract recruiting business, or grow & enhance your pre-established, temp-placement business:

call 800-701-4014 or visit www.people20.com

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