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GUEST COLUMN

Act Now to Implement Profit-Enhancing Changes

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Increasing profitability year to year is a complex and challenging issue that many firms struggle with. Rising compensation and benefits costs, together with highly competitive markets for accounting firm services, strain the profits of both large and small firms.

This issue necessitates a comprehensive assessment and unbiased analysis of the core issues and underlying obstacles. The problems surrounding the ability to sustain higher levels of profitability involving a few basic but difficult core factors to manage are rarely dealt with effectively, such as:

- charging for out-of-scope services on client engagements and the ability to increase fees;
- firms that are top-heavy with partners and senior managers; and
- ensuring the practice is balanced with high-realization clients.

Address Scope Creep!

Scope creep occurs when a firm provides increased services to a client year to year that are out of the agreed-upon services outlined in the engagement letter or contract for services. When scope creep continues unrestricted over a prolonged period of time, it becomes progressively more difficult to bill for out-of-scope services on fixed-fee engagements without formally documenting and informing the client on a timely basis. Unbilled out-of-scope work can easily account for 5% to 15% of a firm's write-offs annually.

I recommend the following steps when scope creep occurs:

- Inform the client immediately, provide an estimate of the additional work, and obtain the client's approval to provide and charge for the out-of-scope services.
- Invoice the additional services during the month they are provided, not when the engagement is completed.

Prior to the commencement of each year's engagement, clients must understand the nature of the services provided in the engagement letter, as well as the services that are not included.

In these increasingly competitive times, firms need to consistently deliver more perceived value to substantiate increasing fees. Every client is unique and will have different perceptions of value. Therefore, it is imperative to know what each client values and expects from their professional relationships with partners and staff.

Failing to establish a value-based and trusted-advisor relationship with the client is the primary obstacle to raising fees. It is vital to maximize communication with each client as their priorities and expectations change over time.

Going beyond the commodity services and anticipating the future needs of clients before they become aware of them will strengthen the relationships and ultimately add value. The old adage is true: "Clients don't care how much you know until they know how much you care."

Ensure Appropriate Leverage

Many accounting firms have become under-leveraged, creating significant problems with succession planning, growth, profitability and staff retention. There is a direct correlation between the ability for partners to delegate and leverage their time and the ability to grow the firm and increase profitability.

The demand and competition for quality staff is a major obstacle to establishing the proper balance, mix and ratio of partners to staff. Many firms have become top-heavy, resulting in partners performing manager-level work, spending less time with practice development activities, and neglecting the financial management of their engagements. Balancing the partner and staff structure is vital to succession planning and current and future profitability.

Some of the questions that firms need to consider in balancing their partner and staff structures are:

- Is the firm carrying too many underachieving partners and managers? Is the firm too top-heavy?
- Does the leadership of the practice need to make some tough business decisions regarding balancing its partner and staff structures?
- Are partners being held accountable for delegating work and increasing profitability on their engagements?
- Is the firm properly developing its staff so that partners and managers can leverage effectively?
- Are partners with high billing rates doing too much low-level work?
- Does the firm's scheduling process take into account the proper matching of work, talent and career development?
- Is there enough "quality" staff in the appropriate positions to have a successful delegation process?

Too often, professional staff members are overlooked from a career development perspective and are regarded as units of production rather than as assets to be developed to attain sustainable increased profitability.

Effectively managed career development programs for staff members, along with performance management systems, lead to greater effectiveness in client service, more new business, deployment of higher-value services and the ability for partners to delegate more work. They also lead to increased productivity and less turnover, which eventually adds to the bottom line.

Upgrade Clients to Balance the Practice

Low-level realization clients drain a firm of valuable resources and become impediments to increasing growth and profitability. They also contribute to a top-heavy organization and a culture of increasing profitability by creating unreasonable amounts of volume versus a value approach to profitability.

Culling clients on an annual basis based upon defined criteria provides the following benefits:

- avoiding hiring expensive staff to service low-profitability work;
- allowing partners and staff to dedicate more time with the firm's best clients to maximize retention and sell additional services to them;

- providing partners more time to market to quality clients and referral sources;
- aiding in the retention of staff;
- permitting staff to focus on quality clients to enhance their career growth with less stress;
- providing time to develop new and innovative services that are more profitable than commodity-type services; and
- creating more time for partners and managers to coach and develop staff on a daily basis, enabling partners and managers to delegate more work to lower-level staff.

Continuously upgrading the client base should be a top priority for increasing profitability. Practice development efforts should be focused on high-profitability client prospects, not just adding more volume. Create specific criteria for accepting new clients and continuing to serve existing clients. Clients who don't meet the criteria should be considered on an annual basis for termination. If partners are having a difficult time deciding which clients should be terminated, they should ask the staff for assistance and input.

Profitability ultimately depends on how well the firm manages its relationships within and among the marketplaces it deals in, its clients, its partners and staff members. Progressive accounting firm leaders understand that increased profitability is not attained solely by managing a scorecard of statistics and ratings. It evolves by maximizing the perceived value of client services, practice and financial management of client engagements, partner and staff performance management, career development at all levels, and a strong emphasis on a results-driven culture of accountability.

Accounting firms are notorious for being slow to change, which can take a toll on profitability. Even when well managed, change is difficult to deal with and accept. However, continuously changing and adapting to the marketplace conditions is imperative in order to increase profitability.

As Charles Darwin said, "It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change." ■

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