BUSINESS PLANNING BY ACCOUNTING FIRMS

A Quick & Dirty Analysis

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Introduction

This research project was not what you'd call a very carefully designed and controlled project and I would not draw any firm conclusions from the results. However it did throw up some interesting observations form which some useful hypotheses emerge.

A total of 262 responses were received to the questionnaire which is attached as an Appendix.

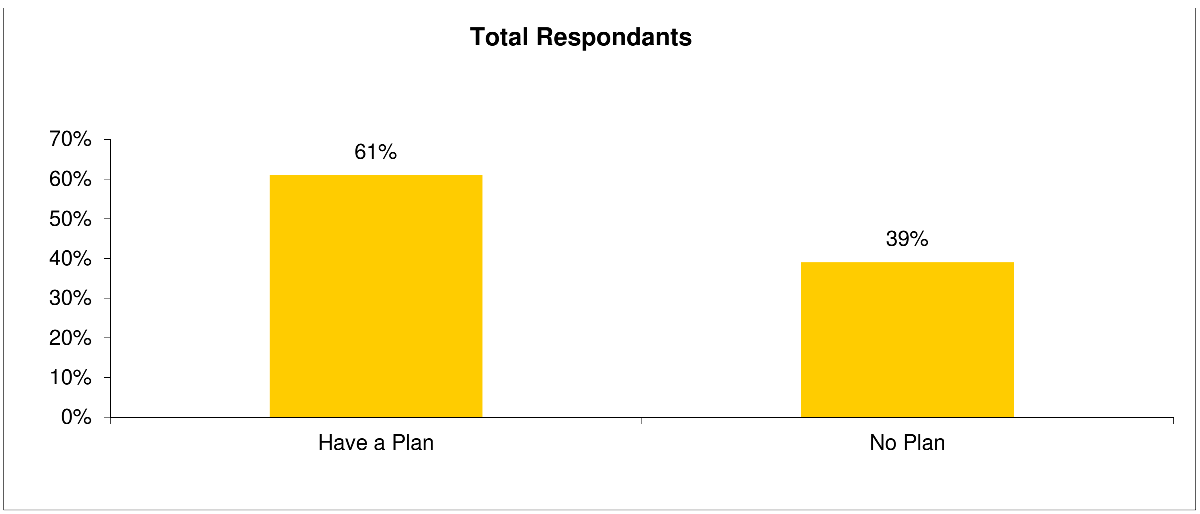
The questions that I was interested in are:

1. Do accounting firms invest time in planning their own business?
2. Do firms that plan, experience greater revenue growth than firms that don't?
3. Do firms that plan and involve their team grow faster than firms that don't involve their team?
4. How frequently do firms that plan monitor their plan and is there any correlation between their monitoring frequency and their revenue growth rate?
5. Do firms that plan have a detailed strategic plan or is their plan simply an operating cash flow and profit plan?
6. Do firms provide business planning services to their clients as a standard service?

The Results

Question 1:

- Do accounting firms invest time in planning their own business?

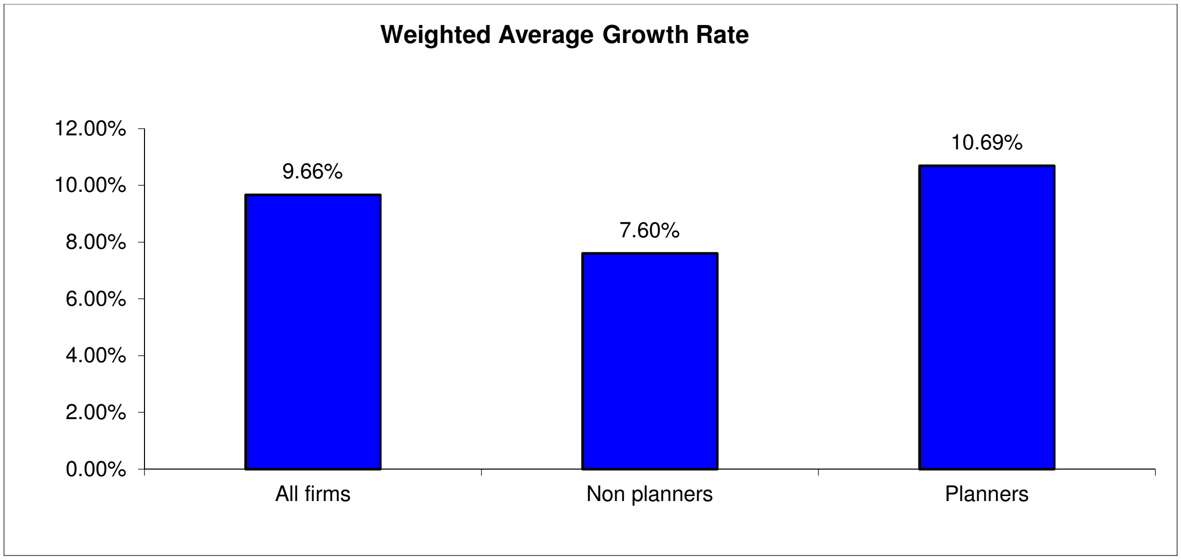


Comment: Most firms in the survey do have a planning process in place. I suspect this is probably a biased result for firms as a whole for two reasons: (1) people who are in Principa 's client and prospect database tend to be accountants who are more likely to be at the leading edge that those who are not, and (2) my guess is that people who do not have a planning disposition are less likely to respond to this type of survey than those who do.

Questions 2 – 4:

- Do firms that plan experience greater revenue growth than firms that don't?
- Do firms that plan and involve their team grow faster than firms that don't involve their team?
- How frequently do firms that plan monitor their plan and is there any correlation between their monitoring frequency and their revenue growth rate?

Weighted Average Revenue Growth Rate: Planners vs. Non Planners



To determine an "average" revenue growth rate I took the mid-point of the ranges referenced in the questionnaire (see the Appendix) and for the option of "greater than 30%" I simply used 30% as the assumed growth rate. I then calculated the weighted average growth rate (WAGR) for each response cohort where the percentage of firms corresponding with each growth rate was used as the weighting factor.

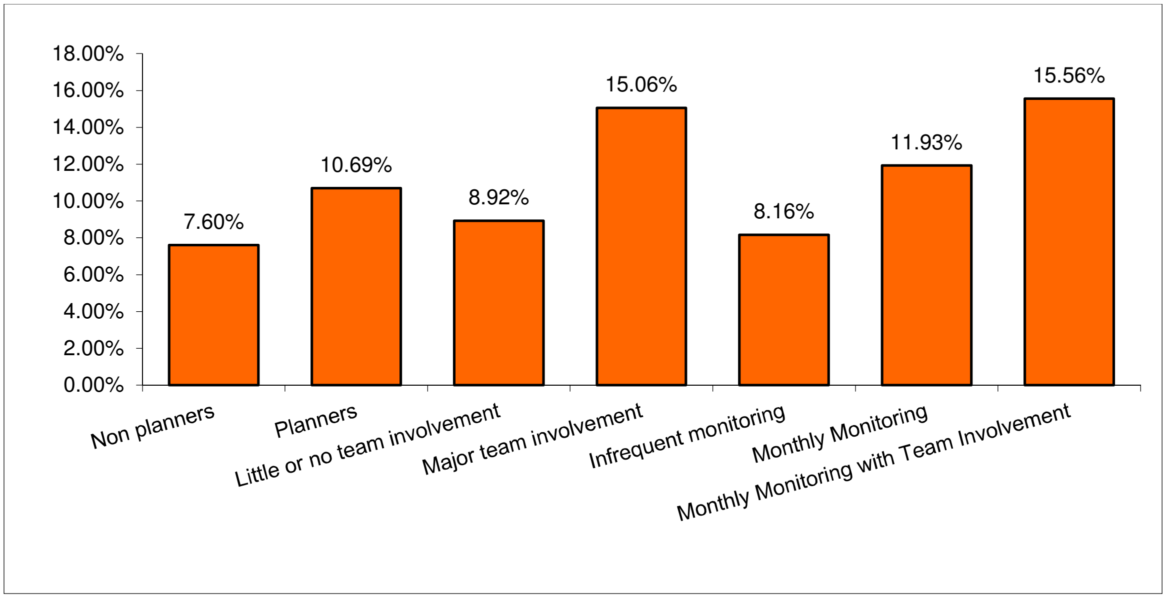
Comment: The results indicate that firms that plan,tyler-moore grow faster than those that don't. The weighted average revenue growth rate for firms that have a plan is 10.69% compared to 7.60% for firms that do not plan.

This may not seem like much of a difference (although it is 40% higher!) However, if you were to extrapolate that growth rate differential over a 10 year period, for each $100,000 of fees you are now generating, the difference would represent approximately $294,000 being left on the table in revenue over the 10 years. Furthermore, assuming a $1:$1 valuation multiple, the additional capital value of the firm in the 10th year would be $68,000 for each $100,000 of revenue today.

A firm that's doing $1 million today would be leaving $2.94 million on the table! For the purpose of this report I'll refer to this metric as the ***Revenue Left Behind***. For each $1 million in today's revenue the incremental capital value would be $680,000 for a $1 million firm.

Before continuing, it's important to comment on the difference between correlation and causation. I again emphasis this is not a statistically controlled study. However, on the assumption the respondents were honest in their answers it is reasonable to conclude that firms that plan exhibit higher growth rates than those that don't. <u>But that does not mean higher growth rates are the **result** of the act of planning</u>. It may simply be that the people running these firms are more disciplined and it is their disciplined style that results in a superior growth rate. If that is the case, going into a back office and preparing a plan will NOT in itself result on your firm achieving industry-leading revenue growth.

Characteristics of the Planning Firms



Comment: The above composite graph shows the relationship between revenue growth (the vertical axis) and various characteristics in relation to the planning process for the 159 firms that prepared business plans for themselves.

Team Involvement in Planning

I'm a strong advocate for involving your team in the planning process because I believe it results in higher levels of engagements and a greater likelihood that plans will be accomplished than is the case when plans are handed down from above, or worse still, not mentioned at all which is tantamount to saying to your team "we're not going to tell you where we are heading."

It seems there's some support for my opinion in the results. The planners that involved their team in the process had a WAGR of 15.06% compared to those planners that did not involve their team. The ***Revenue Left Behind*** is $695,000 for each $100,000 of revenue you now have.

Monitoring Your Plan

What I was looking for here was whether regularly monitoring your plan has any effect on your growth rate. It seems it does.

Other things being equal, the firms that monitor their plans on a monthly basis exhibited a 11.93% WAGR compared to 8.16% for the ones that either didn't monitor or infrequently did so. I believe this indicates that when you monitor your actuals you give yourself an opportunity to implement operational corrections when negative variances arte identified and possibly add stretch targets when you're ahead of target.

This is a message you should be preaching to your clients and what's good for the goose is surely good for the gander. The chants of measurement freaks are "What you can measure you can manage" and "what gets measured gets done." This is what regular monitoring is all about. The message we suggest you spread is as follows: when you have monthly KPI monitoring in place you have 11 opportunities every year to keep your business on track! The ***Revenue Left Behind*** by the non-monitors is $379,000 for each $100,000 of revenue you now have.

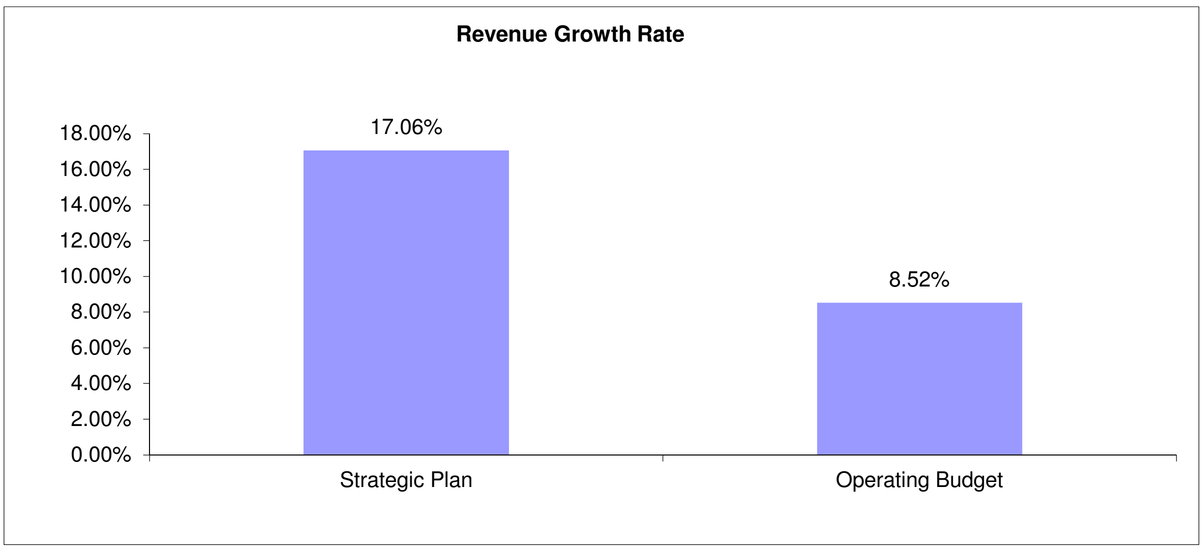
Monitoring With Team Involvement

This is a high management intensity strategy with equally high information transparency. I'm not at all surprised to see the higher revenue growth that is exhibited by these firms. The WAGR is 15.56% versus 11.93% for the firms that plan and engage in monthly monitoring but don't involve their team. The ***Revenue Left Behind*** by the non-monitors is $454,000 for each $100,000 of revenue you now have.

It is interesting to note that when you compare **major team involvement** with **monitoring frequency** it seems that team involvement has a greater impact on results that KPI monitoring. The data are not strong enough to draw too strong a conclusion along these lines but if push came to shove and I had to rely on my gut to say what's the more important management variable to achieve superior performance I would back team involvement before anything else.

Question 5:

- Do firms have a detailed strategic plan or is their plan simply an operating cash flow and profit plan?



Comment: The data suggests that firms which have a fully blown strategic planning process achieve a significantly higher WAGR than those that just have a profit and cash flow plan (P&CFP). This does not surprise me because the P&CFP approach to planning is, for the most part, a very simple and usually very conservative extrapolation of what the firm accomplished in the immediate past year.

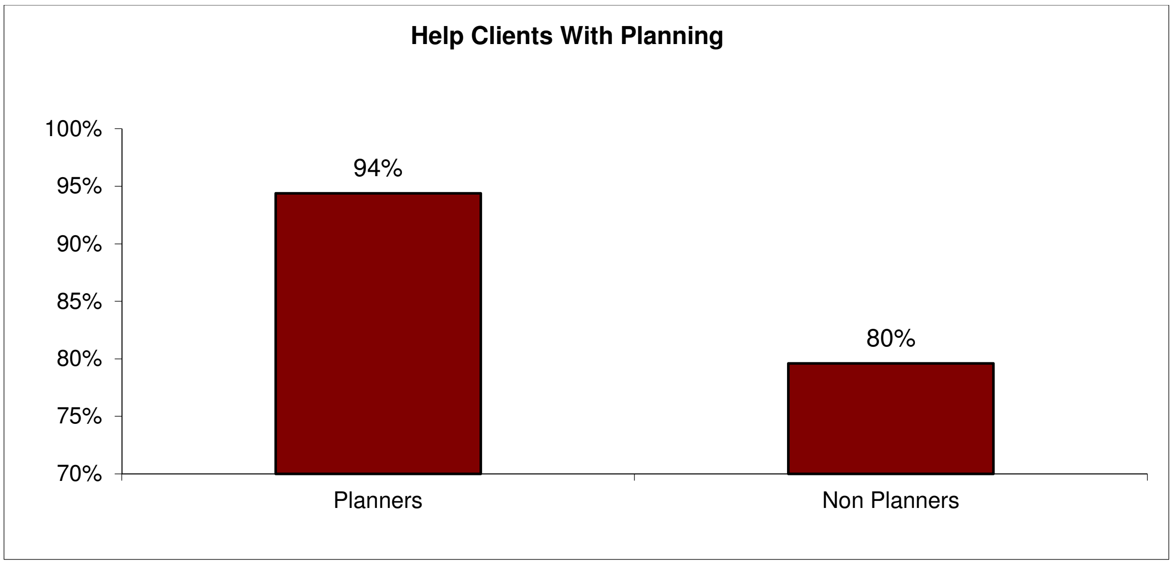
Because of the characteristic stability of the accounting services sector it's not very difficult to forecast with a reasonably high degree of accuracy. A forecasting challenge arises when you tackle an aggressive growth target. What I'm saying here is that it's pretty easy to project out a future based on say a 5-10% revenue growth rate – some of that will come from pricing, some from incremental services to existing clients as they grow, and some will come from new clients. But it's hardly the stuff stories are written about. Because of the high degree of predictability regular monitoring is not usually needed and it is highly unlikely you would either need nor want to involve your team in the process.

And therein lies the real challenge. Firms that have difficulty attracting and retaining talent need to take a close look at their growth targets. Quality people are simply not going to look for a firm that has a growth expectation of 5-10% a year. That is what an average firm achieves. Can you imagine running and advertisement for a new talented team member which reads something like: "If you would like to work with an average firm give us a call." Where is the opportunity for them with that sort of result? These people may come on board to get some experience and a pay packet but if they're any good they will not stay and if they aren't very good they will – in either case you'll have a problem.

The WAGR difference between the strategic planners and the operational budgeters has a huge impact on The ***Revenue Left Behind***. The strategy firms will be $1.017 million ahead over a 10 year period for each $100,000 of revenue you now have.

Question 6:

- Do firms provide business planning services to their clients as a standard service?



Comment: Firms that see the value of planning in their own business are more likely to feel confident in offering that service to their business clients. This is not surprising although the relatively high percentage of firms that do not have their own plans did surprise me but my guess is this is because their clients who have borrowings need profit and cash flow projections so they would typically visit their accountant for help with that task. On the other hand firms that prepare plans themselves understand the value they can be so they proactively encourage their clients to do likewise.

Conclusions

Subject to my opening caveat this study suggests that firms that have a robust strategic planning process in place in which they involve their team members and monitor their progress frequently can expect to be rewarded with a significantly higher revenue growth rate than firms which do not have such a process in place. These firms recognize the value of planning and tend to be more actively involved in helping their clients with planning assistance.

Ric Payne
CEO Principa
May, 2014

APPENDIX

THE QUESTIONNAIRE

A questionnaire to determine the amount of formal business planning you do for your firm and with your clients.

* Required

Do you prepare a formal business plan for your firm annually? *

Yes

No

Do you monitor your activity against it on a monthly basis?

Monitor monthly

Monitor less frequently

Never monitor

Occasionally glance at it

If you monitor your plan, do you change it to accommodate unexpected circumstances?

Yes

No

Only if it is a material change

Do you involve your team in the planning process?

Only respond with 'yes' if you seriously involve them in the process not just ask for their casual input or opinion.

No

They play a major role

They play a minor role

Do you help your clients create their own business plan?

Yes frequently

No

Very occassionally

Is your plan the "operating plan" based on a higher level strategic plan?

Yes it is part of a documented Strategic Plan

No, it is just an operating plan with an emphasis on profit and cash flow projections