Industry Trends

The 10 Plagues of CPA Firm Greatness

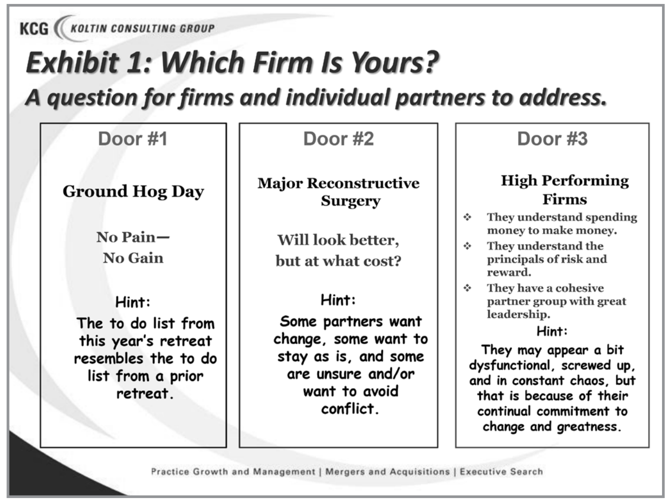
By Allan D. Koltin

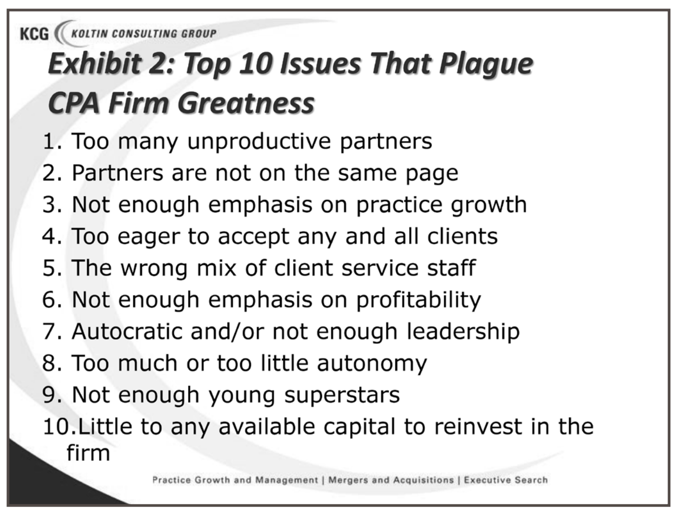
Q: Recently, you spoke at an international accounting conference on the 10 plagues that hinder CPA firm greatness. You also mentioned that most firms with whom you consult could be characterized by one of three doors. Can you shed some light on this? (See Exhibit 1.)

A: Sure. Door #1 represents the majority of CPA firms today and we refer to it as "Groundhog Day." Essentially, the firm takes very little risk and, therefore, there is not much in terms of upside reward (no pain—no gain). The firm also rarely makes a meaningful decision and doesn't have the ability to drive true change. I can typically identify this firm by looking at its issues and "to do" list from prior years' retreats. The tell-tale is that the same issues that were going on in the firm five years ago are still occurring today.

Door #2 represents a firm that is on the uptick and has a mechanism in place to create change and make meaningful decisions. The majority of the partners are in sync, but there are some concerns looming in the future (*i.e.*, succession, growth, future leadership, and so forth). There is something of a tug-of-war taking place because some partners clearly want change and want to get to the next level, while others appear to be cruising and would essentially like things to stay the same.

Door #3 firms, simply stated, are the best of the best! They represent the upper five percent of the profession. These firms have consistent track records for continuous growth, profitability and, maybe most importantly, a deep bench of future stars. Ironically, this group often appears to be dysfunctional and in a constant state of chaos, but it is simply a byproduct of their continuous commitment to self-improvement and constant change. If I had to characterize these firms in one word, I would use "adaptable." Many of these firms are leading the way, not just in growth, but also in winning the war on talent.





Q: You mentioned there are 10 issues that plague CPA firms (see Exhibit 2). Let's examine each issue, starting with "Too many unproductive partners."

A: I recently surveyed a 10-partner firm and nine of the partners indicated that the #1 issue was too many unproductive partners. To get a chuckle, I started the retreat off by asking if the one productive partner in the room would please stand up! All too often, "unproductive partner" means many things to many people, including:

- an equity partner who is no longer performing at that level and should now be an income partner;
- the partner who is simply overpaid based on his or her performance (I always get a chuckle when this topic comes up—especially when firms have closed partner compensation because, in theory, no one partner knows what anyone else makes!); or
- the partner who is divisive and something of a cancer to the firm's culture and should be counseled out or terminated from the firm.

Of the 10 plagues, the last example is the most awkward to talk about and—in a partnership setting—the most difficult to deal with.

Q: Issue 2 is about partners not being on the same page. Would you please elaborate on this?

A: When we use the term "partners on the same page," this can mean many things. It can mean that partners are not in alignment on whether to stay independent or merge up. It could mean there is discord over the current or future strategic direction. It could also mean that many partners are not happy with the compensation program or firm leadership. There are times when I advise firms to take the approach to simply "agree to disagree," *but* then make a decision and get a call to action. I often find that change can take place in firms, but only when the change itself is deemed to be greater than the status quo. It may be obvious, but clearly when partners are not on the same page there is often a breakdown in trust and respect amongst the partners. Sadly, sometimes the wounds are too great and can't be healed.

Q: Your third issue is "Not enough emphasis on practice growth." Does this mean that it's not part of the firm's culture, or does it mean that the firm simply "doesn't have the horses?"

A: Yes, all of the above. In certain firms there simply is not enough emphasis on practice growth, although they have the rainmakers to continue to grow. What typically happens is that the rainmakers have built their own books of business and the compensation program rewards them for essentially hoarding work. In other situations, the firm clearly does not have a strong "growth engine" and needs some type of major retooling. I will often see this in second-generation firms where the first generation has retired (along with their clients) and the firm is beginning to erode due to the inability of the existing group of partners to go out and bring in new business.

A byproduct of this issue is that we often see firms retaining their C and D clients because they don't believe they can replace them with more profitable clients.

Q: Issue 4 is "Too eager to accept any and all clients." Will you shed some light on this?

A: There's an old expression that says, "Garbage in produces garbage out." A low-realization client on Day 1 will rarely convert to a high-realization client. I have also learned that firms that allow individual partners to make their own decisions on client acceptance typically have realization rates five to 10 percent lower than other peer firms. Great firms have built a "mousetrap" on client acceptance and will only let clients in the door that are consistent with the firm's strengths and are the type of client that the firm has the ability to service.

Don't get me wrong. I am fine with strategic investments in certain industry and service lines and accepting work at a lower realization rate during slower times of the year. I just find that all too often in many firms this goes from being the exception to being the rule!

Q: Your fifth issue is "The wrong mix of client service staff." I assume this is different than "not enough client service staff"?

A: You are absolutely correct. It is rare when there are simply not enough people to do the work. The bigger issue has to do with the mix—when you have partners doing manager work, managers doing senior work, and so forth. When we talk about this issue with firms, it typically is being caused by one or two issues, such as:

1. The partner's talent level is such that he or she is probably a senior manager with the title of partner and is simply performing at the highest level he or she is capable of.
2. The firm simply won't make the financial investment to build out the proper staffing levels and will do everything on a somewhat haphazard basis.

High-performing firms have clear delineations as to what partners, managers, and staff should be doing and they "hold court" when it comes to how they service clients.

Q: Issue 6 is "Not enough emphasis on profitability." Does this refer to short-term or long-term profitability?

A: The true answer is that it probably refers to long-term profitability because any firm can manipulate its numbers to show high profits in a given year. To use a David Maister term, many firms will show high profitability over a shorter period of time, but truth be known, they are "asset milking" the practice and not making any of the necessary investments to build a better firm for tomorrow. The superior firm would be one that is "asset building" and understands that long-term profitability is something that will take place over many years. These firms have a belief system of wanting to protect the firm and its legacy, and believe they will be highly profitable in the long-term, but will tell you they are currently on the journey and may never reach that destination. Interestingly, I find that these firms typically out-perform the majority of the profession, both in the short-term and in the long-term, because they have done a great job of planting seeds over the years and getting partners to be focused on the longer-term targets of sustainable growth and profitability in a "one-firm" environment.

Q: Your seventh issue is "Autocratic and/or not enough leadership." Are you referring to the managing partner/CEO position?

A: Clearly, it all starts at the top, so focusing on the CEO/managing partner is a great place to begin, and often that is where many of the issues reside. This could range from the partners not trusting and/or respecting the leader to the leader not spending enough time working on the business (vs. in the business). It could also be a skillset issue, where the leader is lacking communication skills, is too much of a micro-manager, or is weak in terms of strategic vision and change management. Having said this, in larger firms we need to go beyond the CEO position and apply the same test to department heads, industry, and service-line leaders, as well as those in other professional management positions. Simply stated, leadership deals with taking the firm or a group to the next level, management deals with getting results through others, and administration is necessary but typically doesn't involve significant change or controversy (*i.e.,* changing partner behavior). Managing partners need to play in the boxes of leadership and management and delegate many of the administrative issues to someone who has that skillset.

Q: Issue 8 is "Too much or too little autonomy." I assume here you are dealing with firm culture as much as anything. How do autonomous firms typically perform vs. highly accountable firms?

A: You have identified the two extremes in most CPA firms—those that are highly autonomous (I'm a partner and I'll do whatever I want!) to those that are highly accountable (each partner essentially commits to agreed-upon goals, almost in the form of a "contract" and knows their compensation at year end will hinge greatly on their ability to achieve these goals).

Recently, when I was analyzing the Top 100 CPA firms in the country, it hit me that I could easily put these firms into three buckets, A, B, and C. I would guess about a third of the Top 100 firms are truly A performers and, not surprisingly, operate in a highly accountable culture. B performers typically perform well, but due to their mix of being semi-accountable and semi-autonomous have too many leaky buckets and can't get the kind of breakthrough results that the A firms typically have. Lastly are the C firms, which scream loudly that they want a more accountable environment, but when push comes to shove, what the partners are really saying is that they would like to see everyone else held to a high level of accountability, but they would like to stay autonomous in terms of what they want to do!

We refer to this as the "country vs. country club" firm. If the firm is a country, everyone puts their hands in the middle and accept leadership's change, putting the firm first and their individual needs second. Alternatively, at the country club firm, partners pick and choose how they want to interpret each policy and procedure and get upset when leadership challenges them on why they are doing things differently than what was agreed upon.

Q: Your ninth issue is "Not enough young superstars" within the firm. Are you referring to associates and/or partners here?

A: Think in terms of a professional football team when they show the depth chart by position. Every decade, firms need to replace talent at virtually every position. These positions could involve leadership skills, rainmaking skills, client management skills, and technical skills. Not surprisingly, most firms have strong technical and client management skills, but typically are light in terms of rainmaking and leadership skills.

I recently told a firm I was working with that it was almost as though they had missed the equivalent of the NFL draft for the last 10 years, in terms of attracting young talent to the firm. The average partner age was mid-50s and, while they had younger talent in the staff at the manager and partner levels, truly they would have been hard pressed to identify real superstars. Our search group often receives calls from firms looking for young, dynamic superstars but, unfortunately, many of the issues in this article continue to plague the firm. Truth be told, younger superstars can see through many of these items today and have a decision tree in place that will only allow them to be associated with a winner.

Not long ago, I talked to a college graduate who had received offers from the Top 10 firms in his market and I asked him why he chose a particular firm. He said that everything was pretty much a wash, except for the fact that the firm he chose had admitted more new partners over the last five years at a ratio greater than 2:1 vs. all the other firms. Clearly, today superstars can see under the sheets and know how to decipher an A vs. B vs. C firm.

Q: Finally, Issue 10 is "Little to any available capital to reinvest in the firm." Could you share what you mean by this and the type of investments that are typically made?

A: Sadly, I will occasionally come across firms that are in significant debt and want to maintain their current compensation levels. Sometimes I will even hear from older partners saying they are not going to put another dollar of capital into the firm. Firms that choose to pull every dollar out of the firm each year or operate with a lot of debt are at a major competitive disadvantage vs. firms with no debt or those that have a philosophy of retaining profits and reinvesting in the future.

Oftentimes when I'm doing strategic planning with firms we'll come up with our list of strategic initiatives for the year, which typically revolve around investments in new products and services and recruiting top talent, only to find the firm doesn't have the capital and, for sure, the partners don't want to make less money in the current year than in the prior year. For me, this is the absolute moment of truth, when we go through the painful task of identifying what the strategic opportunities are for greater growth, profitability, and overall self-improvement and the partners choose not to put their money where their mouths are.

As you can imagine, this issue can create quite a bit of "campus unrest" when you have a group of partners willing to invest in the future and another group stuck in the mud, typically closer to retirement, and not seeing the benefit of these capital investments today. I often have to remind these "close to retirement" partners that, ultimately, if they want to see their deferred compensation payments made over the next 10 years, they too should hope that the firm continues to survive, or they will run the risk of being caught on the short end of retirement payments as well. This item, as much as any item on the list, often leads to a discussion about an upstream merger and, unfortunately, sometimes even leads to a potential breakup of the firm or, at a minimum, a couple of partners leaving. Firms need to have alignment when it comes to strategic vision and, equally important, the necessary investment to grow the firm.

In closing, I often ask partners to rate each of their plagues on a 1 to 10 scale (with 10 meaning this is us vs. 1 meaning this is not a problem at our firm) and total the score. It is fascinating to see how partners at the same firm can see the world so differently!

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