Industry Trends

How Firms Can Go from Great to Good

The five early warning signals to watch for.

By Allan D. Koltin

Q: At a recent practice management conference, you provided a keynote directed at high-performing firms. Was this a bit of a warning that even high-performing firms can take their eye off of the target and not even know it is happening?

A: The obvious problem with a great or high-performing firm is that complacency can set in and, to make matters worse, sometimes the firm won't even realize it is happening. It only takes a couple of years for great firms to become good firms, but it can take an entire decade for a good firm to turn into (or return to) a great firm. It should also be noted that sometimes the trend of complacency won't jump out immediately, as oftentimes excellent financial results can continue for a handful of years, thus masking what is truly going on behind closed doors.

Q: If you had to point to the one or two biggest changes that start firms on the path from great to good, what would they be?

A: Without a doubt, the two biggest items would be leadership and growth.

Great leadership is imperative because it drives the firm forward. It causes the partners to continue to grow professionally, take risks, and add to shareholder value. David Maister coined the phrase many years ago when he talked about an "asset milking" vs. "asset building" firm. An asset milking firm is all about pulling out profits today and not reinvesting for tomorrow; whereas, an asset building firm is all about creating a better and more prosperous tomorrow.

Growth is the other big factor. Profitable growth can go a long way to carrying the firm. It allows for the admission of new partners, and it causes profits to continue to go up and thus provides additional capital for continued strategic investments. Lastly, it also provides a culling process to cut out unprofitable clients, or at least find a way to make them more profitable than they are now. In the absence of profitable growth, we hold onto what we have and are forced to accept and keep marginal clients.

Q: When it comes to human capital, what things might we see in a firm that is going from great to good?

A: Great firms distinguish themselves by being able to recruit top talent away from other firms. They also have what I refer to as an awesome signature story. A signature story talks about the firm's greatness to date, but more importantly, it paints a vision of an even more successful firm in the future. To great recruits or lateral hires, the signature story encapsulates their goal of being able to get in on the "ground floor" and achieve infinite career growth and opportunity in the years ahead. But, as you know, it is not just about getting great talent in the door. It is also about *keeping* great talent.

In my experience, great firms seem to do three things better than other firms:

1. pay the highest wage (in order to do this, they need to be very profitable);
2. provide the best training (in order to do this, they need to continue to reinvest profits); and
3. provide the quickest career advancement (in order to do this, they need to continue growing the firm).

One could argue that these things cost the firm money (and short-term profits) with no promise that those investments will pay for themselves in the future. I believe it is a gamble worth taking.

I find that firms in transition from great to good slowly take their foot off the accelerator in terms of making strategic investments in human capital. They may not do it all at once, but instead over a period of several years. Then, one day they wake up and ask, "How come we haven't recruited any superstars into the firm over the past couple of years?"

They also realize that some of their superstar talent has left the firm to explore other career opportunities elsewhere.

I am a big believer that each firm needs to keep track of two significant metrics that I think, to a large degree, dictate the future success of the firm. The first metric is what I'd refer to as "Superstar Talent Recruited," and the second metric is "Superstar Talent Retained." It amazes me how often we get mired in financial statistics of billable time, book of business, realization, and other items, while forgetting that the two biggest indicators of our financial future are (1) the inbound recruitment of stars and (2) the retention and development of existing stars. As one departing superstar told me, "This firm has become a group of siloed partners who only care about their own compensation."

Q: In your presentation, you talked about leadership and decision-making and compared them to a speedboat and a big ship. Could you elaborate on this?

A: I think great leaders make great decisions. However, when you peel the onion on great decisions, there are a couple of items at play. The first is the speed with which leaders can make decisions. Great firms have great CEOs and, more importantly, allow them to run the business. Unfortunately, a trait of good firms is that they are so concerned about consensus and having all the partners on board that they end up much like a rudderless, cumbersome big ship. I have observed firms over the past couple of years that felt their leaders weren't doing their jobs and rather than simply replacing the leaders, they attacked the structure in which decisions were being made. In business circles, it is referred to as "participative management" and, unfortunately, when many people are involved in decision-making, it often reduces itself to the lowest common denominator. Decisions become watered-down and end up being Band-Aids at best.

What we find in great firms is that the dynamics of fierce leadership and the ability to move the firm forward resembles the dynamics of a great captain on a speedboat. Firms need to be careful when it comes to decision-making and understand that it is a three-legged stool involving partners' willingness to be managed, the skillset of the leader, and the governance structure (decision-making process). I realize it is a delicate balance, but firms need to continue to remind themselves of what got them to great in first place. Jack Walsh (former CEO of GE Capital) said it all when he stated that the best leaders and decision-makers get it right a little more than half the time. The worst decision makers have a very high batting average, but can't make a meaningful or tough decision if their life depended on it.

Q: You talked about talent in your presentation and the different types of partners in CPA firms. Could you tell us more about those differences?

A: Yes. I have often described partners in CPA firms in terms of the three C's:

1. partners who are content;
2. partners who are climbers; and
3. partners who are crazy.

I will acknowledge that every firm has all three types of partners. When the content partners begin to make up the majority, however, the firm is on a crash course to good, or possibly even not-so-good.

Let me define these partner categories a bit:

- *Content.* These partners are happy with the status quo and don't want change or anything involving risk. Some of them might be close to retirement. The last thing they want to do is see the firm invest its capital (and profits) in things that may or may not produce a financial result and, if it does, it may not happen for a couple of years. Content partners are typically not open to new ideas and want to continue doing exactly what they have always been doing. It should be noted that sometimes even younger partners fall into this trap. Content partners stand at the base of the proverbial tree and simply don't have the "gas in the tank" to climb the tree.
- *Climbers.* These partners are all about new challenges, new risks, new opportunities, putting the firm first before themselves, and are the majority delegation inside great firms. They live in a world of asking themselves each year if they are worth more to the firm and to their clients. They have the "gas in the tank" to climb the proverbial tree and have their foot on the accelerator.
- *Crazies.* These partners, as you can imagine, are the ones that are never satisfied, always pushing the firm forward, and to some degree driving the other partners "crazy." When these leaders come back from conferences, they are chock full of new ideas that they want to implement. (If there were one more metric that I would want to measure, it would be "New Ideas That Actually Get Implemented.")

Great firms are a unique balance of a couple of crazies, many, many climbers, and just a handful of contents. Good firms, on the other hand, are characterized by a majority of contents, with a handful of frustrated crazies and climbers. In this environment, these crazies and climbers typically reduce down to the lowest common denominator (*i.e.,* contents) or they find salvation outside the firm—typically at another firm!

About the author: Allan D. Koltin, CPA is the CEO of Koltin Consulting Group, based in Chicago, Illinois. Allan specializes in the areas of partner compensation, firm governance, profitability, strategic planning, succession, practice growth, human capital, and mergers and acquisitions. Allan can be reached at either *akoltin@koltin.com* or 312-805-0307. ✦