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The value drivers of the modern firm

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With an estimated 10,000 Baby Boomers retiring every day, thousands and thousands of accounting firms and practices are going to go up on the block over the next few years, putting pressure on their owners to make sure they've built a strong value proposition for potential acquirers or merger partners.

Valuations have long been based mostly on the size of a firm's book of business, with firm value expressed in multiples of revenue; that's still a common denominator, but the multiple is now driven by a host of different factors, some intangible, and few of which owners can afford to ignore.

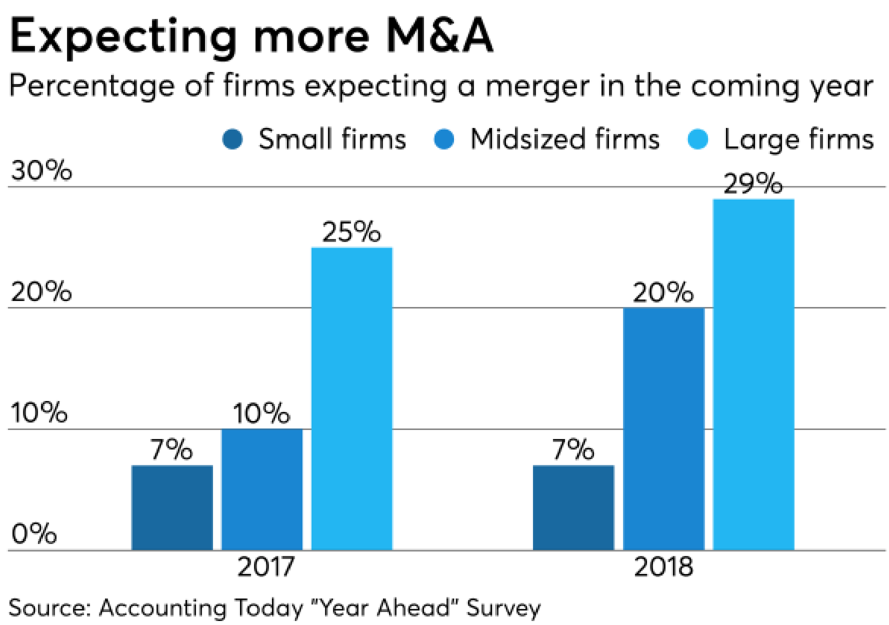
The best of the best

Given the rapid pace of technological change in the profession, especially over the last decade, many experts see up-to-date tech as a firm's crown jewel, both for itself and as an indicator of other important qualities.

"The processes of what we once considered the traditional accounting firm are rapidly evolving," said Joel Sinkin, president of consulting firm Transition Advisors. "With the advent of such technologies as blockchain, AI and robotics, what we used to refer to as Type A audit and tax work will be fully automated in five to seven years. Firms that are proactive to these quantum changes will invariably carry a higher value than those who aren't."

"Say you have two firms looking to merge into a larger practice," said Carl Peterson, vice president of small firms at the American Institute of CPAs. "One has technology using portals – whether it's CCH or Thomson Reuters or what have you – but a consistent platform which gives them efficiency and effectiveness. If that's there, automatically it has value when someone is looking to acquire them. Firms that don't have that definitely start to drop in value."

"If a firm is [tech-savvy], they probably have remote access, telecommuting policies in place at their firm, communicating with clients on their smartphones or iPads to connect it with their financial reporting," continued Peterson. "If the firm has that, then internally they must have the same sort of progressiveness, so that the staff are able to utilize the same type of technology, and I think that impacts directly on recruitment and retention."



Personnel issues

A healthy client roster is still important, but so is a strong bench of talent within the firm itself.

"Firm leaders need to be focused not only on new business development, but internal development as well," said Sinkin. "To recruit successfully in today's profession, firms need to break out of the 1980s mindset of 9-to-5 and offer such options as flex hours, working remotely, and getting their staff engaged with clients as soon as possible. Today's Millennials are not going to remain long at a firm if they're relegated to a cubicle and working 2,000-plus hours in hopes of making partner."

"If I had to pick one thing that leaders should do to ensure that these values continue forward, it would be to make sure that the firm's partner compensation system is performance-based and, more precisely, has individual partner goals tied to the firm's overall strategic plan," said Allan Koltin, CEO of Koltin Consulting. "These would take into account each individual partner's (or team member's) highest and best use of time, as well as their unique skills. You know you have a successful partner compensation program when talented people are performing at the highest level and also feel that they are being treated fairly from a compensation standpoint."

Having employees with broad, deep skill sets makes a firm attractive to potential acquirers. "Firms [can] promote staff to be involved in state societies and the AICPA, but also involved in other industry-specific organizations … those are opportunities to develop those soft skills," said Peterson. "If firms don't do that, and they're totally focused on billable hours and not giving staff the opportunity to participate in those things, I think that's a very old-style firm and not very progressive. They're just not giving opportunities to people that should be built into their firm culture and the value's not there. You'll notice that when you talk to these young people, how involved they are, and there's value there."

The value prop

A strong, collaborative firm culture, continuously reinforced, produces engaged staff members and leaders alike, while also giving it a unique identity in the market.

"The culture [would have] what I would refer to as a 'bunker mentality' when it comes to helping others," said Koltin. "When there's a cry for help, the culture dictates that they stop what they're doing and always try to help others when they're faced with a problem or obstacle. Another way of saying it is, individuals in this type of culture always put the firm first, the team, department or office second, and their personal wants and needs third. People in these firms know that when they're in the bunker, there's always a team of others committed to covering their backside."

"[It's] giving staff constant feedback and interaction," added Peterson. "You'd have a formal process … but informal interactions with staff keep that going and keep them motivated. It just shows that the leadership is aware of what's going on and is looking to maintain that culture. Even in a small or medium-sized firm, people can be moving around and not necessarily meeting each other, but you still have to have those interactions."

There's also value in promoting a firm's unique angle -- finding what makes a practice stand out and accentuating that.

"A firm's value often depends on the eye of the beholder, so to speak," added Sinkin. "Value is often linked to the strategic objectives of the firm that is assessing the value. One firm may perceive a practice doing a lot of 1040s as having a low value, but another firm who feels it can cross-sell its services to those 1040 clients or perhaps it can help streamline and improve that firm's 1040 work process may see a far higher value. If I were a smaller firm, value to me would translate to having 'trained clients' -- those that pay on time, have great retention, and are ripe for cross-selling opportunities."

"When it comes to the firm's service offerings, whether it be industry niches, products or services, the firm [should be] able to claim 'market fame' in a couple of key areas," added Koltin. "Oftentimes, the firm has done a great job in establishing itself as the dominant player or expert in this area, and behind the firm they have a couple of individuals, also known as 'famous people,' in these service areas."

Getting the word out

A firm can be chock-full of valuable assets, but they're all for naught if potential acquirers or merger partners aren't aware of them. Therefore, firms need to be just as committed to promoting their strengths as they are to developing them in the first place, both by cultivating a strong reputation among clients and other members of the profession, and by always being ready to support positive word of mouth.

"Firms today need to really be prepared to have an elevator pitch of who they are, what their culture is, and be able to say that in a relatively short commentary to anyone they're talking to," said Peterson.

“No one wants to look at a brochure or go on a Web site and read pages and pages about who you are. I think you can narrow that down to an elevator speech and you’re a lot better off.”

“I think the best way to measure these things would be by producing an annual report or ‘state of the firm’ summary,” said Koltin. “That being said, there are many telling benchmarks that high-performing and successful firms share both internally and externally. They include net promotor score; the results of client satisfaction surveys; upward evaluation results; partner peer evaluation results; associate engagement surveys; and awards or recognitions.”

“I would break it down into two distinct categories,” advised Sinkin. “With regards to the staff, I would share the skill sets and leadership capabilities of a firm’s high-potentials, as well as the veterans. With regard to the client base, it’s critical to know and understand your firm’s metrics — retention, receivables, realization rates, etc., as well as demonstrating the growth potential of niche services the client base may be open to but the firm may not currently be offering.”

Eight key value factors

Allan Koltin shared this checklist critical factors for building and demonstrating firm value:

1. A track record of continual growth and, equally as important, profitable growth -- a firm’s “growth engine.” If you don’t grow, you’ll die (worse yet, it will be a slow death). Too often I find that when firms don’t have a strong growth engine, they end up accepting all kinds of work. Oftentimes that work is low margin or with a higher level of risk tolerance than should normally be accepted.

2. Great leadership. When we talk about great leadership it includes not just the managing partner, but also the majority of industry, department, and team leaders. Great leadership is the catalyst that keeps people connected and provides the coaching, mentoring and feedback to allow individuals to achieve and exceed their performance potential. They also understand the balance of accountability and autonomy, and do a great job of letting the entrepreneurs strive for greatness, while at the same time providing the necessary balance and guidance.

3. The firm has the proper balance of critical skills among the partner group. Whether it be rainmaking, client service, leadership, technical skills or the ability to grow talent, highly successful firms are strong in all areas. I find that one of the greatest differentiators between a good and a great firm is that at good firms the partners excel in one or two of these areas but, unfortunately, don’t have the skillset to cover all of these areas.

4. The firm’s “farm team” is loaded with future partners and leaders. If there were one item from this list in which we see great separation from firm to firm it would be the ability to recruit and, more importantly, retain and grow future starts. When I ask firms to identify their “A” players, the response I typically get back is that they have a solid team, with good workers, but not necessarily enough (or any) future partners and leaders.

5. Having a “mousetrap” for recruiting top talent, not just at the college campus level, but also at the experienced talent level. These firms typically are winning the awards as best places to work or employer of choice and are the firms that top talent looks to join when they are looking to make a career move. As part of this, they have also demonstrated a successful track record of taking experienced hires and laterals and providing an environment that allows them to achieve their potential at a much faster pace than their predecessor firm.

6. Being able to claim "market fame" in a couple of key areas. Oftentimes, the firm has done a great job in establishing itself as the dominant player or expert in a particular industry niche, product or service, and behind the firm they have a couple of individuals also known as "famous people" in these service areas.

7. A "bunker mentality" when it comes to helping others. When there's a cry for help, the culture dictates that they stop what they're doing and always try to help others when they're faced with a problem or obstacle.

8. Balanced profitability. Not only does the firm continuously increase its profitability, but equally important, it is balancing innovation with profitability. That means making the necessary capital investments in areas such as talent, technology, training, product development, leadership development and other key areas, while at the same time having the business discipline, efficiencies and systems to continue to produce a high profit. There are many firms in the industry today that are high profit, but they are doing it at the expense of reinvesting dollars today for a better tomorrow.