# THE EVOLUTION OF THE ACCOUNTING PROFESSION

## How to Position Your Firm to Survive the Coming Disruption

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# The Upcoming Disruption

**The Evolution and Future of the Accounting Profession**

# Table of Contents



 

# Chapter 1: Introduction

My name is Jeff Pawlow and I am the Managing Partner of The Growth Partnership – a 20-person consulting firm headquartered in St. Louis, Missouri. We have been working almost exclusively with public accountants for the past 18 years and have developed a keen understanding of what it takes for a CPA firm to grow.

Before founding The Growth Partnership in 1999, I served as the director of marketing for both a "Top 50" accounting firm located here in St. Louis, and prior to that at a large local firm in Madison, Wisconsin. Preceding my entry into the accounting profession almost 25 years ago, I worked in the business banking world where I learned how to successfully market and develop business in the professional services sector. I was able to draw on that background to drive my initial success with CPAs by simply transplanting proven business development techniques that were commonplace in the banking world, but almost unheard of in the accounting profession.

During the initial part of my career in accounting, I was the recipient of 7 Marketing Achievement Awards from the Association of Accounting Marketing (AAM), including the "Best of Show" award in 1996 (with the firm that I was working for in Madison) and again in 1997 (with the firm I was working for here in St. Louis). If that competition was held today, the marketing initiatives that were recognized by those back-to-back awards probably wouldn't make it past the first round of the judging, mainly because the way firms market and develop business today has become so much more sophisticated over the past 20 years. That said, I'm concerned that perhaps something important has been left behind during that evolution…

Many firms today seem to believe they can simply "buy their way" to growth. In other words, if they just figure out what the "right" marketing strategy is or what the right business development initiative might be, they can just simply write a check to fund those programs and growth will happen in and of itself.

 

Unfortunately, nothing could be further from the truth.

I strongly believe that if firms want to develop a culture of sustainable, profitable growth they must return to the foundational principles of business development. This begins with a keen understanding that at the end of the day, this is a relationship business. The profession demands that its practitioners forge a great deal of professional intimacy with their clients, prospects and referral sources if they truly want to succeed.

With that as a backdrop, let's examine how the public accounting profession has evolved over the past several decades. This is important perspective for practitioners who want to successfully navigate the disruption that lies ahead.

## Chapter 2: Profession 1.0 – "Forty Acres and a Mule"

The historical accounting profession shared a lot with the agricultural economy. Like that 40-acre family farm, early CPA firms were somewhat self-contained and almost totally self-reliant. All firms were somewhat homogeneous, with one local firm basically indistinguishable from the next. Competition for clients and staff was virtually non-existent and practitioners were the product an apprentice-based profession that rewarded technical excellence above all else. The collegial nature of the environment led to public accounting being known as the "gentlemen's profession", and it served as a gateway for many children of traditionally blue-collar families to make the jump to the white-collar world.

Up until about 30 years ago, you could pluck a practitioner out of a firm based in St. Louis and drop them in a firm out in San Diego, and while the décor and office ambience might be a bit different, the day-to-day reality would have been almost identical. The sole emphasis of a CPA in the historical model was placed on technical excellence: debits toward the window, credits toward the door, wear your green eyeshade, and keep your pencil sharp. If you did those things well and built a solid reputation for yourself and your firm, everything would take care of itself.

 

# Chapter 3: The First Disruption

In 1977 the public accounting space experienced a major disruption that changed the collegial nature of the profession forever. The case of *Bates versus the State Bar of Arizona* served as a major turning point for all professional services firms (go figure, it was the lawyers that got us in trouble) and ultimately led to the culture of cutthroat competition that exists today.

Attorney John Bates concluded that his practice could not survive unless the availability of legal services at low cost was advertised. At the time, the State Bar of Arizona had a strict prohibition on advertising of any kind and moved to suspend Bates and his partner Van O'Steen for a period of six months. The case went all the way to the Arizona Supreme Court where the they agreed with the Arizona Bar and affirmed the prohibition on advertising. The case then advanced to the U.S. Supreme Court where the Arizona Court's ruling was overturned and the prohibition on advertising was removed.

While it was no longer illegal to advertise, both the American Bar Association and the AICPA immediately reaffirmed they considered advertising to be unethical and worked aggressively to minimize such practices. This allowed CPAs to continue to practice in a "1.0 world" for some time, but the seeds of disruption had been planted and it was only a matter of time before the genie was out of the bottle.

With the introduction advertising and open solicitation of clients and professionals came the new reality of marketplace competition that greatly diminished the historical collegiality of the profession. As such, a new paradigm began to emerge that required firms to practice in new and different ways. If 1.0 was the agricultural economy, 2.0 became the industrial revolution.

 

## Chapter 4: Profession 2.0 – "Like A Business"

In response to the increasingly competitive landscape, CPAs began to see themselves in a different light. While technical excellence was still paramount, the new MAP (Management of an Accounting Practice) movement was taking hold which challenged CPAs to run their firms "like a business" with greater emphasis placed on management, marketing, human capital, and technology. This is when the notion of the accounting firm as a factory took root: CPAs gather raw materials (their client's data and information) and brought it onto their factory floor (their firm) where is was refined to produce finished goods (tax returns, financial statements, etc.). This "industrial" mindset was further fueled by the introduction of new technology – specifically the microcomputer.

### The Advent of Technology

I've been around just long enough to remember two rooms that used to exist in every CPA firm: the file room and the library. The file room was where we kept all of a client's historical documentation, and the library was where all of the manuals, books, and resources that were needed to actually practice accounting were housed. Today, both of these rooms have been replaced by technological alternatives.

As recently as the mid 90's, "LOL" was not "laughing out loud" – it was the "little old lady" that most firms hired to keep watch over the library. Her job was simply to sit at the library desk and ensure that no materials got out, because losing any of the "books" would compromise a firm's ability to do work. I remember watching accountants in the library sitting at large tables with books and huge pads of paper to make calculations, prepare financial statements and tax returns, and calculate depreciation tables.

New and rapidly evolving technologies quickly put an end to the need for a file room or a library, and for the past 25 to 30 years we've been diligently working to make our firms perform faster, better, and cheaper. Microcomputers became desktops, which became laptops, which became iPads and smart phones. A small, single, monochromatic screen has given way to quad “retina” monitors and high definition displays. Today these technological efficiencies have automated some processes so well that it almost seems like the work is doing itself.

**Pricing Pressure**

Our professional “factories” have become so efficient that tremendous pricing pressure exists in the market – especially in the core service areas. If you run your factory efficient enough, low bids can yield high profits, especially as the core “compliance” services become almost indistinguishable between competitive firms. As a result, prices get lowered as firms attempts to secure the work. This “race to the bottom” when it comes to fees has negatively impacted many firms who still rely on the core services for the bulk of their revenue.

# Chapter 5: The Next Disruption

Just as the profession evolved from the 1.0 "agricultural economy" to the 2.0 "industrial revolution," we now find ourselves at another inflection point and must prepare our firms accordingly.

I do quite a bit of speaking at association and State Society conferences, and over the past five years there has always seemed to be that one "novelty" breakout session that proclaimed the existence of a second disruption in the accounting profession. With buzz words like automation, blockchain, and artificial intelligence, futurists were beginning to sow the seeds of knowledge for what lies ahead as we move to a new (and yet to be defined) 3.0 paradigm.

This past year's speaking season was remarkably different from previous years, as the "novelty" breakout session moved center stage. The volume of chatter has gone up and the message has become mainstream: disruption is once again at our doorstep.

**Will Robots Take My Job?**

Want proof that disruption is just around the corner? Take a look at the website www.willrobotstakemyjob.com and type in what you currently do for a living. Auditor? There's a 94% chance your job gets automated in the next 3 to 5 years. Tax preparer? Your odds are worse, with a 99% chance the robots will be taking over. In fact, we can already see the impact of these new technologies at play. For example, we have several clients with agricultural niche practices who are exploring how to perform inventory counts by using drones. This method promises to be far more efficient than having staff drive from silo to silo recording the amount of grain stored in each, and as a result, the drones are poised to eliminate the need for a human worker. This paradigm is only going to accelerate as RFID technology becomes mainstream and the inventory starts to count itself.

On the tax side, we're already at the point where tax returns almost prepare themselves. We scan all the client's information and the computer pre-populates the tax form. We've been reduced to being more of a reviewer of the final product as opposed to somebody who actually prepares the document. Someday soon, even complex returns will "self-prepare" as more and more systems integrate with each other.

**Core Services**

According to this year's *Rosenberg Survey*, the profession's authoritative annual benchmark of accounting firm operations, more than 60% of the baseline accounting firms' revenue is derived from the core services mentioned above. Imagine the stress that will be placed on these firms as the majority of their practice comes under disruptive pressures. This resulting fee pressure will force a radical evolution at a very quick pace as firms struggle to adapt to new realities.

In order to thrive, successful firms are going to need to develop a skill set that isn't easily found in their historical training and education. In order to bridge this gap, it's necessary to have a clear sense for where we're going.

## Chapter 6: Profession 3.0 – "The Knowledge-Worker Age"

If Stage 1.0 was the agricultural economy and Stage 2.0 was the industrial revolution, I believe that Stage 3.0 will be referred to as the "Knowledge-Worker Age". At this stage, firms will face one major overarching question: **Why on earth would a current or prospective client pay us a premium fee when they can get the same core services from a firm who is probably just as technically excellent as we are at a significantly lower price?** Firms that can't credibly answer that question are really going to struggle to thrive against the backdrop of disruption that's in store for them over the next 3 to 5 years.

### How to Command a Premium Fee

So why would a client choose you over someone who's just as technically excellent and offering their services at a discounted rate? A recent survey asked client of CPA firms what are their top concerns were and what they wanted from their accountant. While tax minimization and compliance came in at the top of the list, the third biggest need was "better business management" – a concern expressed by 68% of survey respondents.

Essentially, these business owners are saying they want their CPA to apply their specific industry and technical experience and expertise against their unique situation. They want an advisor, not just an accountant. They want consulting, not just compliance. Unfortunately, we are all products of a profession that has trained us to report on what has happened (looking backwards, as opposed to ahead) and to find the mistake (as opposed to recognize the opportunity). In the Knowledge-Worker Age we are going to need to pivot if we want to successfully navigate the disruption ahead by bringing our unique ability and perspective to bear on our clients and their operations.

This is why firms continue to become more and more specialized along specific niche areas of practice. It is hard to be an "expert" in multiple niche areas, but relatively easy to achieve that level of proficiency in one or possibly two. By doing small well, we are able to command a premium fee because we're bringing more to the table than just debits and credits. It is our unique knowledge, experience, and perspective that allows us to function as trusted advisors.

So how do we make this pivot successfully? How do you teach an old dog new tricks? To begin this transformation, we must first get back to basics and recognize that, at the end of the day, this is a relationship business.

**Relationship Business: Back to Basics**

How many clients make up 50% of your overall book of business? How many more does it take to reach 80%? For the average partner or manager, this is often a surprisingly small number. In our experience, we've found that just 12 clients often account for 50% or more of a practitioner's book. Even so, these "key" clients aren't always recognized as such and are often served no better than the smaller clients who make of the rest of the client ledger. This has to stop.

Consider your top 12 accounts. Can you articulate with confidence their specific goals for this year? Have you read their strategic plan? Do you have a keen understanding about what makes them tick or what might be keeping them up at night? For the small number of clients that make up 50 to 80% of your book, you need to see yourself as a surrogate CFO – a person who can help them improve their financial position and shed some light on the twists and turns that lie ahead.

Unfortunately, we often hear that there isn't enough time to provide this level of engagement or proactive advice. In other words, there just isn't enough time to take impeccable care of my very best relationships because I'm too busy meeting the demands of the rest of my client portfolio - who may only contribute 20% to my overall revenue. This is like saying "I'm too busy driving to take the time to stop and get gas". It's not going to work out well for you in the end.

## Chapter 7: Where Growth Comes From

As you begin to focus on growth in the Knowledge-Worker Age, start with the understanding that growth comes from one of four areas: 1) client management, 2) client expansion, 3) client acquisition, and 4) client retention. Let's briefly look at all four.

Client Management - If you raise your rates and you hold realization and utilization the same, you will collect more money and be more profitable. If you keep rates the same but improve realization, you're going to be more profitable because you've collected more of the money that you've actually billed. If you better leverage the work being done on an engagement you will again increase profitability. Rate, Leverage, Utilization, and Realization are the four levers of practice management. Successful firms manage these variables religiously.

Client Expansion - In this area, we more deeply engage our existing clients and sell additional services as a result of that deepening relationship. We consider what else we can do within these existing relationships to expand and bind them to us over time. We do that by offering additional services beyond the core compliance that they're used to receiving. This is all predicated on having a high level of professional intimacy with the client.

Client Acquisition - We do this in one of two ways: The first, is by being the recipient of a referral from a banker, lawyer, insurance agent, or financial planner that knows us and trusts us with one of their relationships. Referrals are valuable because they already pre-sold and provide us with immediate legitimacy in the eyes of the potential client.

The second way to acquire clients is through direct targeting. This entails going through a process of identifying prospects that look like our very best clients, creating a positive first-impression with them, gaining permission to keep in touch, and then professionally sowing seeds of discontent between them and their current provider. This is done by consistently demonstrating thought-leadership in the prospect's space.

 

Client Retention - The fourth way, which isn't as intuitive as the first three, is to limit your client attrition rates. On average, your firm is going to lose between 5% and 7% of its revenue every year just through the normal course of business - losing a client because they've gone to another competitor, were acquired, went out of business, or whatever else the case might be. As a result, you essentially start each year down 5 to 7% and having to dig out just to remain even.

Of course, you cannot prevent clients from going out of business or from being acquired from different companies, but you can convince your current ones to stay with you. One way to do this is by surveying your clients to see if they're satisfied with your service and if they're loyal to your company. Starting the year down 2% instead of starting at down 7% means you've got a 5% head start on the year.

**Finding Your Most Important Clients**

You can clearly see that a big portion of a firm's growth depends on how they manage their existing clients. Like I said before, it's a relationship business.

First, you need to find out who your most valuable clients are – those who collectively make up 80% of your firm's billings. I recommend doing the same exercise our firm does each year during the second week of January. On January 15th, our controller runs a report that lists all of our clients from the previous year organizing by how much we billed them. Our largest client is at the top of the list, followed by the second largest client, and so on. We start at the top and begin adding the annual fees together until we've identified 80% of our firm's revenue. Last year, we found that 23% of our total clients produced 80% of our total revenue. That means that less than a fourth of our total client base was responsible for the vast majority of our revenue.

This also applies at the individual practitioner level as well. Personally, just 11 clients make up 87% of my practice, and collectively they represent about 34% of our overall revenue as a firm. If I'm going to survive the disruption that's coming, I really need to double down into those specific relationships because those are the ones I have to defend, those are the ones I have to expand, and those are the ones that I have to compel to pay me a premium price knowing that my competitors are out there willing to do it for less.

So, how do I do that? I simply make sure that, for each of those 11 clients, I identify the specific people in their organization that I need to keep happy and establish a cadence of proactive interaction with each one of them.

For example, we've got a large client in Cleveland, Ohio that we do a big leadership development program for. While there may be 20+ people in our database who work at that firm, there are only three I really need to keep happy if I want to perpetuate, expand and defend the relationship. My (our) fate truly rests in their hands.

Once these key stakeholders are identified, I need to ask another question which is: how many times over the course of a year should I meet with each of them over and above what they have already engaged us to do? These “growth” interactions are usually conducted face-to-face and are solely designed to deepen the relationship over time, and the frequency may be different based on the role and relationship of each person.

One of the people that I often meet with is the firm’s senior tax partner who also has partner level accountability for the leadership program. I think it's important to meet with him face-to-face because I want to deepen the relationship over and above what he's paying me to do for them twice a year.

Another person that I manage is the firm’s director of Learning and Development because I know that my competitors are calling on her on a daily basis. I interact with her once every quarter which is higher than usual because I want to hold her a little bit closer to me.

 

The last person that I focus on is the firm's managing partner. I don't have as much bandwidth with him as I do with the other two, but he signs my checks and at some level so I want him to feel that the leadership program is contributing his goals and objectives. I've got him set up for a single interaction every year to make sure I can connect those dots.

Once I've defined who I need to have these growth interactions with and how often they need to occur; I need a system that will hold me accountable for actually doing them. What I've learned is that whenever these interactions take place, I learn things that I wouldn't have otherwise known which in turn allows me to be a better advisor.

**Building Your Brand**

In addition to proactively developing more professional intimacy with our most important clients, prospects and referral sources, we must also elevate our personal brands to thrive in the knowledge-worker age. The easiest way to do this is to position ourselves as the person who somehow manages to deliver the right piece of content, to the right contacts, at exactly the right time. This "rifle" approach is significantly different than your current e-newsletter strategy that is tailored more to the masses.

For example, one of the leading e-newsletter platform providers publishes an annual whitepaper to tout their product's analytics. They of boast their e-newsletters have an open rate of 29% and the click-through rate of 6% which is evidently superior to their competitors. If you do the math, you quickly realize that for every 100 e-newsletters that are sent out, only about 30 emails actually get opened, and even fewer people actually click through and read one of the articles. While efficient, the e-newsletter can easily be sent to large numbers of recipients, this isn't exactly effective if you're trying to get a key piece of information into the right hands, and it certainly isn't contributing to the development of your personal brand.

 

What I have found to be incredibly effective is to deploy a strategy of surgical content delivery over a sustained period of time. This is actually easier than it may sound, especially if you're limiting your focus to the 20 percent of client who contribute 80% of your revenue. Use your e-newsletter to keep in touch with the other clients, but develop a cadence of robust content delivery for your key relationships. This "nurture" approach will yield deeper conversations and engagement because it is so narrowly focused on the needs and interests of a select population.

Here is a great example of an e-mail that was sent to 37 clients who were in a position to take the R&D credit for the first time on their 2016 returns as a result of the new PATH Act.

Subject: A Great Read - I Immediately Thought of You!

From: Jeffrey Pawlow – jpawlow@thegrowthpartnership.com Signature: Signature #1

Peter,

Take a look at the article I have linked to this message. This is spot on given your current situation, and I'm happy to report that I expect you to be eligible to take the R&D credit beginning in 2016. Here's an executive summary of the larger article:

> ***AMT Taxpayer? Have we got good news for you!***
>
> *For years, many business owners that would qualify for the R&D tax credit felt frustrated at their inability to claim the credit because they were individually subject to the Alternative Minimum Tax (AMT).*
>
> *Beginning with the 2016 tax year, this is no longer the case as the recently passed PATH Act allows taxpayers whose businesses qualify for the credit to apply it against AMT.*
>
> *While credits from previous years can not be carried forward and applied against AMT, credits from 2016 and beyond will qualify. This represents a significant tax break for many small and medium-sized business owners.*

Let's be sure to discuss this in greater detail the next time we meet and look at what the potential tax savings might be. While every situation is unique, I do believe this represents a significant opportunity for tax savings this coming year.

Please don't hesitate to call if you have any questions.

Best,

Jeff

Notice how the e-mail is crafted. It is written in a way where the recipient believes it was only sent to them, but as you look closer, you understand that this message could have been sent to all 37 clients by only switching the recipient's name. Even though this campaign was "one-to-many", for each recipient, it felt like it was "one-to-one". Image the powerful brand that you can build over time if you maintain a cadence of this type of correspondence with your most important clients.

As you build your brand, your ability to command a premium fee goes up, even in the face of low price competitors. This premium will be an important asset to you and your firm during the disruption that lies ahead.

**Synergy**

The final thing we should is acknowledge is that multi-partner firms need to practice synergistically if they are going to drive the maximum value into a client relationship. Too often I see CPA firms that are simply a collection of sole practitioners that have banded together to share overhead and administrative expenses. These "co-op" firms will struggle in the years ahead because it will be increasingly hard for a lone practitioner to serve the evolving needs of their clients.

Instead, firm leaders need to create systems that compel practitioners to work interdependently as they approach a client relationship. 1 + 1 needs to equal more than must 2. In a synergistic firm, it can equal 3, or 10, or 1,000. Simply put, successful firms will need a system to ensure that the right hand knows what the left hand is doing and that information is being shared robustly among practitioners.

A good example of this might be an audit partner who is taking one of her clients out to play a round of golf as one of the "growth" interactions she is scheduled to participate in. During the round, the client mentions they are about to break ground on an expansion to their plant. The audit partner is smart enough to know this new construction represents an opportunity to perform a cost-segregation study, but is also not the person who would lead this engagement. Ideally, a system is in place that would allow her to come back to the office, capture the information and alert the tax partner about the opportunity, and create a task for the tax partner to follow up with the client.

While this may seem like common sense, it often is not common practice. When it happens though, it is a beautiful thing because the client gets served at a higher level. This in turn drives increased loyalty because the client knows the firm is proactively looking out for their best interest and bringing them timely advice.

**Making Common Sense Common Practice**

How do we hold each other accountable for doing the things that we need to do to create dynamic practices?

Earlier I mentioned that we actively manage the top 80% of our revenue at The Growth Partnership. We have a system in place that allows us to see the health of all those relationships at a glance, and are very transparent and with one about the health of those key relationships. Our system is called ABLE (www.growwithable.com) and it has provided an inexpensive platform to help us grow our practice. Specifically:

- Provide dashboards that confirm in real time if our scheduled major interactions are taking place;
- Easily share compelling content in a targeted fashion to our clients, prospects and referral sources;
- View an active pipeline of new business opportunities, and track both inbound and outbound referrals;
- Actively collaborate across multiple practitioners using robust CRM tools.

As you consider how to best prepare for the disruption ahead, ask yourself the following questions:

- Why would a client choose to pay me (or my firm) a premium fee in the face of low price competition?
- Do we have systems in place that focus us on driving value into the handful of relationships that really matter?
- Can I easily share meaningful content with tightly defined populations?
- Do we practice synergistically?
- Are we accountable to one another?

When you can answer “yes” to the questions above, I believe you are adequately prepared to successfully navigate the disruption ahead. Welcome to the Knowledge-Worker Age!

Best wishes for continued success!

 