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Invest First, Then Reap Powerful Profits

You have to spend money to make money.

—Anonymous

"Give me heat and I'll give you wood," said the freezing man. There was no reply from the stove.

How much should we spend on marketing and sales? What elements should be included in a marketing budget? Should the salary of a marketing director be included? What about the hours that professional staff members spend on networking, entertaining, and proposing? Is sales a part of the marketing budget? How do I track the results of marketing expenses?

These are questions frequently asked of me by CPAs who are nervously contemplating marketing programs. Sometimes I speculate that the questioners would rather not spend anything or are looking for an excuse to reduce the cost of marketing. Bruce Marcus, in his book *Competing for Clients in the '90s*,¹ says, "Professionals have one foot on the boat and one foot on the dock when it comes to commitment to marketing."

CPAs are better trained in expense control than in revenue generation, and thus they are biased in that direction when it comes to their own firms. No wonder confusion exists about how best to assemble a marketing budget. CPAs lack confidence that marketing can add to their profitability. They also worry about how much to invest and where it should be invested. Add to these factors the long selling cycle for accounting services and the results orientation of many accountants, and we can begin to understand the difficulty.

But CPAs *are* experts at budgeting. Why then is constructing a marketing budget so difficult? I don't think the problem is with the budget. The budget is simply a marketing plan quantified; the problem really is developing and managing the plan. Failing to commit to a budget after the plan has been agreed on is the CPA's way of keeping one foot on the dock.

Marketing Is an Investment Activity

A paradigm shift is necessary for many CPAs when they plan marketing. To successfully plan and budget, CPAs should view marketing as an investment rather than an expense. Expenses should be reduced, but well-managed investments increase firm value and partner income.

“Marketing dollars are strategic, and strategic costs are the long-term lifeblood of the business. Marketing investment must be maintained in good times and bad,” says management consultant Bob Fifer in his book *Double Your Profits*.² Many CPA firm managers miss this point when they employ their “blood from a turnip” marketing-budget reduction strategy.

CPAs are not the only businesspeople who are skittish about a budgetary commitment to marketing. Lee Iaccoca, quoting John Wannamaker, once said that he knew that most of Chrysler’s advertising budget was wasted and that if he only could identify the successful portion, he would spend only that. But in spite of his skittishness about advertising, Iaccoca dramatically increased the marketing budget of the ailing Chrysler Corporation. More important, Iaccoca managed the marketing budget wisely so that he achieved consistency, integration, and leverage from his marketing investment.

Both Iaccoca and Fifer define strategic costs as all those things that clearly “bring in business” and improve the bottom line. “Nonstrategic costs are all other costs which don’t bring in business,” says Fifer.

An accounting firm has two investment commodities: cash and time. Assembling a marketing budget should encompass both. David Maister, author of *Managing the Professional Services Firm*, says, “A major responsibility of firm management is to set the ground rules for investment of firm funds.” Marketing is fundamentally an investment decision. Maister says, “A competitive advantage doesn’t come free.”

Most CPA firm accounting systems treat all strategic costs as expenses rather than as investments. According to Maister, “Partners subject to the ongoing financial control systems of the firm postpone or avoid investment activities for fear of being judged as missing their income target.”

How Much Should I Invest?

Various MAP (Management Accounting Practice) studies and the AICPA survey indicate that most accounting firms spend 1 to 3 percent of their firm’s revenue on marketing. Most of these surveys account for only the out-of-pocket marketing costs and generally do not include an allocation for part-time staff costs. Anecdotal information indicates that some of the more aggressive firms spend upward of 6 percent on marketing. One consultant

told me that if a firm would not commit at least 3 percent to marketing, he would not work with them.

Some CPAs have had significant success with aggressively stimulating new business through well-managed marketing. Because of the high gross-profit margin, increases in revenue can improve profits dramatically. The objective is to increase fee volume with as little erosion in gross margin as possible. Most accounting firms have a variety of products, some of which provide recurring fees. Marketing spending directed at generating a recurring income stream could be viewed as an investment amortized over several years rather than only one year.

Hypothetical Return on Marketing

A \$33,000 investment produces \$100,000 new revenue:

Total revenue per year	\$100,000
Gross margin percent	33%
Gross margin	\$33,000
Life expectancy of client	7 years
Profits over seven years	\$231,000
Discounted value @ 10%	\$161,000
Marketing costs (investment)	\$33,000
Total profit	\$128,000
Annual average (after payback)	\$18,000
	(55% annual return)

This income statement assumes that one-third of every incremental revenue dollar is direct cost, one-third is overhead, and one-third is profit before partner compensation.

A model called the available gross margin theory provides a gauge for measuring the upward limit for marketing investment. If a 33 percent profit is generated from each incremental dollar of new business, then an investment of up to \$33,000 in marketing to generate \$100,000 of new business would be profitable in the first year. Generating \$100,000 of recurring business with a 33 percent margin, a firm would receive payback in year 1 and \$33,000 additional profits each year thereafter. The discounted value of \$100,000 of additional revenue over a seven-year client life expectancy, with a 33 percent margin (using 10 percent interest), would be \$170,000. Investing \$33,000 in acquisition costs would reap a 55 percent annual return after payback.

Using these calculations, we can understand the significant potential for a well-managed marketing program. In the short run, a CPA firm could gain up to a 67 percent margin on each incremental dollar of revenue generated

at standard rates. Investing the full 67 percent into marketing could be a wise decision, particularly if the income were of a recurring nature. After obtaining a new client, cross-selling additional services and price optimizing can raise the margin significantly.

Do not set your marketing budget at 33 or 67 percent of expected revenue. That is a range for new client development only. A solid marketing budget will allocate a similar amount of investment to existing client building and some portion to positioning.

Setting Your Marketing Budget

Once you decide your marketing objectives and action plans, you can set a budget amount. For example, a practice grossing \$1.5 million that seeks \$75,000 in new client recurring revenue could budget up to \$50,000 (dollars and time). If the revenue were totally nonrecurring, \$7,500 to \$15,000 (10–20 percent) would be the upper limits, barring any unusual factors intervening.

A well-balanced marketing budget would allocate about 45 percent for new business, 45 percent for existing clients, and about 10 percent for positioning. Using our example of a firm investing \$50,000 in new client acquisition (\$1.5 million gross billings), the total marketing budget would be approximately \$110,000 (7.3 percent of past revenue and 6.6 percent of future revenue). The budget may be made up of 50 to 60 percent time and 40 to 50 percent dollars. Firms maximizing chargeable staff hours (utilization rates over 75 percent) would allocate more dollars. If staff utilization is below 60 percent, then management of the available time for marketing would be warranted.

What Methods to Use

A marketing budget based on affordability, competitive parity, or industry ratios can be set up easily. But these are the least effective and most wasteful methods. Discussed in order from the poorest to the best, here are the five methods CPAs use in setting a marketing budget.

1. ***Investing what you can afford in marketing encourages impulse spending after good months and discourages marketing after poor months.*** This method violates the rules of consistency and integration. A retail CEO once remarked that CPAs market like the retailer who didn't advertise in December because he was too busy stocking the inventory. After tax season, when CPAs are flush with cash, they begin to market: at a time when prospective clients' needs for their services have diminished. Affordability is the worst criterion on which to set your marketing budget.

2. ***Matching the competition forces you to react, not lead.*** “Most truly successful and profitable businesses outspend their competition in marketing either in absolute dollars or as a percentage of sales,” says Fifer. Accountants have the potential for an excellent return from their marketing investments, but they must commit enough to make a difference.
3. ***Allocating a percentage of past sales impedes growth.*** “If you look backward to determine your marketing budget, you are looking in the wrong direction,” says Jay Conrad Levinson, author of many *Guerrilla Marketing* books.
4. ***“Investing based on projected revenue forces you to look into the future to act instead of react, to make and keep a commitment, and to be consistent,”*** recommends Levinson.
5. ***Using the objective/cost approach enables you to allocate the marketing budget among competing programs and to maximize profit.*** This method requires you to set objectives and marketing needs and then determine the cost to attain the objectives.

Detailing Your Marketing Budget

To prepare a good budget for marketing, two key elements of information are important:

1. How, and on what, have we spent our budget in the past?
2. What are our current objectives?

To determine what has been spent in the past usually requires accountants to reformat the firm’s income statement into functional rather than natural categories. A functional statement will delineate every aspect of the revenue stream (price increase, product mix, discounts, etc.).

The expense side will delineate and contain an allocation of full-time and part-time employee costs devoted to marketing as well as out-of-pocket marketing items. However, perks for employees, such as country club dues, donations, and similar items, should be excluded unless they truly are used for marketing purposes.

There are five key elements in the market planning and budgeting process:

1. Market communications
2. Client decision process
3. Media
4. Personal selling
5. Push versus pull

Functional Statement

Product Lines	Audit	Accounting	Write up	Tax Prep	Tax Planning
Average charge hours for each staff level					
Hourly rates for each staff level					
Blended hourly rate					
Hours billed					
Gross fees					
Markups (initial)					
Markdowns (continuing)					
Net fees before bad debts					

Prepare a separate budget for each of these marketing areas:

- Market positioning, selection, segmentation, product planning, and pricing
- New client attraction systems, target marketing, creating awareness, and differentiation
- Client sales (new and existing)
- Existing client building, loyalty, price optimization, cross-selling, and developing referrals

Within each budget, use the functional expense categories in the box on the next page.

For a firm wishing to have a balanced marketing program, these rules of thumb would apply:

	Dollars	Hours
Marketing communications (All reallocated to the functional areas; develop a budget worksheet for this.)	40%	15%
Positioning	10%	10%
Internal marketing	50%	75%
Breaks down as:		
New client attraction	17%	25%
Client sales	17%	25%
Existing client building	17%	25%
<i>Total</i>	100%	100%

This formula is not a pat answer for allocating the budget. A brand-new firm may allocate 80 to 90 percent of the budget to new client attraction and sales, whereas a mature firm that has a recent history of client turnover may devote 75 percent to existing client building. Two problems tend to occur if a mature firm with no recent client losses focuses too much marketing on new clients:

1. Clients begin to feel they are being taken for granted and their loyalty declines.
2. The potential revenues from price optimization, cross-selling, and referral building are missed.

Marketing Objectives

Market share should also be considered when allocating the budget. Often it is very difficult to increase your market share if you already have a large share. If your market share is high, your marketing focus should be to optimize profits through building client loyalty, cross-selling, and raising prices.

Now, prepare the marketing objectives in concert with the firm's overall objectives. Before setting a budget, establish a set of marketing actions, such as networking or newsletters, to achieve the objectives. The marketing budget represents the quantification of each of the programs.

A good marketing plan should have consistency, integration, and leverage. Consistency is simply a good fit between the various elements of a marketing plan. For example, a firm that seeks to market estate planning services would not achieve consistency with a yellow pages ad. Yellow pages shoppers are primarily impulse or price shoppers and typically are not in the market for an estate plan.

Picture the ideal client you want to reach. Then coordinate your different marketing efforts to reach them in different ways but to appeal to them in a consistent way.

—Rick Crandall, *1001 Ways to Market Your Services: Even If You Hate to Sell*

Integration suggests that there is a harmonious interaction among the elements of your marketing plan. To continue to use the estate planning example, your marketing would be well integrated if there are elements of market positioning, new client marketing, and existing client marketing in your plan to sell your estate planning service.

Leverage comes into play when each element of your marketing plan is used to its best advantage to support the total marketing mix. For example, the awareness portion of the marketing budget is focused on a group of prospects who later in the selling cycle may be candidates for estate planning. Throughout the marketing cycle, estate planning is mentioned to help pave the way for the later sale.

Once the objectives are in place and the budget step of the marketing process is set, ask these questions before finalizing the plan and budget:

- Are the marketing budget elements consistent?
- Do the elements form a harmonious whole?
- Is each marketing program being used with its best leverage?
- Does each marketing program meet the needs of the target market?
- Do the marketing communications programs and target markets build on the firm's strengths?
- What information will be communicated? How receptive are the target consumers? How complex is the message? What is the number, heterogeneity, and accessibility of prospective clients?
- Does the marketing mix create a distinct personality in the market and offer any protection from your competitors?

Summary

Of all professionals, CPAs should be experts at budgeting for marketing. Remember that marketing is an investment that should bring measurable returns. The best marketing can pay for itself in the first year, plus provide ongoing revenue. Budget to achieve specific marketing objectives. Focus on existing clients more than prospects and choose from the many marketing methods available. Then track your results and build your practice.