

# Realization: The Quickest and Most Effective Way to Increase the Bottom Line

*By Bryan Shelton*

When partners try to use realization to make clients feel better about the fees they are paying, the result is to make clients put less value on their services. Here's how to reverse that trend.

**R**ealization is a very interesting metric in the accounting industry. Many firms view write-downs as a necessary evil; a way to make clients feel better about the fees they are paying, prevent an uncomfortable conversation with a client, and hopefully maintain the client's loyalty for another year. Looking at realization as a trend in the industry, we have seen slight increases in the past few years; however, we have also witnessed fees drop for the same clients. This pattern concerns me as a consultant to the accounting industry. Looking in as an advisor, realization should not be a necessary evil, and it eats away at an accounting firm's profit margin one percentage point at a time.

## Realization and value

Realization is a measure of value in an accounting firm. More specifically, it measures how much an accounting firm values the work it produces for their clients. Many professionals immediately write off completed work as a habit; they look at the previous year's bill and write the new bill making sure the numbers are relatively close without much regard for the actual work involved or the value the product provides to the client.

People buy accounting firms' services for the expertise provided. They value the services you offer, but it is the accountant's responsibility to show this value and remind his or her clients of the value. Cutting fees tells a client you don't view your work as valuable or you feel like you're charging too much. As opposed to making clients feel better about the fees, cutting fees can create doubt in a client's mind and lead to increased questioning of fees or your skills.

If you think about your last project, it did not take the firm the 30 billable hours stated on the invoice to complete the project. It took you and the professionals around you much longer. How so? Accountants have an expertise that no other profession has. Accounting professionals spend many years training at universities, becoming certified, and they gain real-world experi-

ence working on other projects. This is what gave you and your team the expertise to complete that project in 30 hours. Value what you do, and your clients will also value it.

## Realization and communication

If you are cutting fees, you are probably not proactively communicating with your clients. Accounting is not alone in having to make changes during an engagement or project. Construction contractors, for example, constantly have to make changes according to customer whims, budget constraints, and the availability of materials. However, unlike contractors, some accountants hide fees and do not communicate increases in fees that become necessary for various reasons. This causes fees to be higher than expected and places the accountant on the reactive side when dealing with the charged fee. Lack of communication is not an acceptable reason for a write-off and for hurting the firm's profitability. Firms must have (and use) a clearly outlined change order process for partners to hold each other accountable for being proactive with their clients.

It is also important to understand that it is okay for clients to question fees. Clients question fees for a number of reasons: (1) they don't understand why the fee is so high, (2) they don't see the value, or (3) because they can. We have already covered how you should reduce reasons 1 and 2 from occurring. Dealing with number 3 is different, and it is critical to understand why clients will question fees when they know what the fee is going to be (because you have kept them informed), and the service is very valuable to them. Owners of companies know that reducing expenses means more money for the bottom line. The more people who owners ask for a reduction in fees, the more likely they are to receive them, which produces more on the bottom line for them; so they ask. It is also very important to understand that the answer "no" is acceptable to this question. Owners are asking because they have been

successful in the past and there is no reason to decrease your profitability to increase theirs.

### Realization, billable hours, and process improvements

We have seen realization, on average, trending up lately in the accounting industry. However, we are also seeing a decrease in fees for the same clients. Although some of the fee decreases may be due to economic issues, others seem to be occurring because of process improvements. Accounting firms invest in many ways to make their processes more efficient, including going paperless, computer enhancements, and software improvements. These investments cost firms a great deal of time and money to implement, but the hope for all of these improvements is so work can be completed more efficiently. For these investments to pay off (and pay for themselves), a firm must decrease the amount of time spent on projects and charge the same, if not more, for the project. Project timeliness is valuable to your clients; however, you also have to make sure the investment is good for your firm as well. The only time fees should be decreased due to a project no longer requiring the billable hours it once did is when the value for the service is no longer higher than the fees charged. Even then, when considering a reduction in fees, you must make sure the value of the firm's investments is considered when proposing the new fee.

Many firms see a decrease in billable hours for the same client load as a warning sign. However, successful investments in process improvement initiatives will lead to a decrease in billable hours. Don't be shocked when this happens. What this means for the firm is you have created additional capacity within the firm's professional staff, and partners should be focusing on business development. A decrease in billable hours within the same client load is a green light, not a warning sign.

### Realization and billing rate increases

We have seen many firms raise their billing rates year after year just to decrease the realization rates collected. I have often heard partners comment that when the firm's standard rates went up, they were unwilling to increase the bill accordingly and increased their write-down, therefore decreasing the realization rate. Looking at the math, focusing on increasing billing rates while

Exhibit 1: Net Fees Analysis

|             | Baseline    | Increase Realization 3% | Increase Fees 3% |
|-------------|-------------|-------------------------|------------------|
| Gross Fees  | \$1,000,000 | \$1,000,000             | \$1,030,000      |
| Realization | 85%         | <b>88%</b>              | 85%              |
| Net Fees    | \$850,000   | <b>\$880,000</b>        | \$875,500        |

maintaining the current realization rate (or to the detriment of the current realization rate) is the wrong approach. Exhibit 1 shows the results of increasing realization by three percent and increasing billing rates by three percent having the same realization.

As you can see, focusing on increasing realization leads to \$4,500 in additional net fees for the firm over raising billing rates and maintaining the same realization.

This analysis brings me to a question: "Why will firms raise fees when they have not yet maximized realization?" The answer I am led to is this: raising fees provides a front-end way to increase net fees without having to manage a partner group. Increasing fees is not

a substitute for managing a firm's partner group; don't increase fees because you are afraid of setting expectations and managing your fellow partners.

### Realization and moving forward

Accounting firms need to maximize their realization. Accountants provide clients with the expertise to run their businesses more effectively, save their hard-earned money, plan for the future, and protect their assets. Accountants also have a business to run—and people who rely on the firm to feed their families. Part of running a business is protecting profitability, and realization eats away profits by every percentage point it drops. However, the inverse is also true; partners who believe in the value they provide and openly communicate with their clients capture additional profits within their firm's client base.

Do you want to improve your firm's realization? Here are seven suggestions to get you started:

1. *Put together a realization team.* This should be two to three partners and can include the managing

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partner. This team will allow for delegation and accountability within the team.

2. *Conduct a realization study by examining overall realization, department realization, niche realization, and individual biller realization.* The goal is to determine where the firm is experiencing large write-offs so you can then determine why.
3. *Set realization standards within your firm.* Depending on the size and service offerings of your firm, you could have one or many realization standards. Require all billings to be at or above standard or require managing partner approval before the work is billed. This will prevent unnecessary write-offs or allow the managing partner a coaching opportunity with a reluctant biller.
4. *Improve low-realization clients.* Now that standards are set, give each partner a list of their low-realization clients (with highest write-offs amounts first) to develop realization improvement plans. Have each partner report back to the group during regular partner meetings what he or she will be doing to increase the realization per client.
5. *Empower clients who are bad for the firm to make a choice.* Every firm has a handful of clients who have many or all of the following characteristics: needy, slow pay, eat resources, lack respect, question billings, and unprofitable. You should empower these clients to make a choice on whether or not they can continue to be a client of the firm. Either they become a better client to the firm by eliminating the characteristics that make them a bad client or they find themselves a new accounting firm. One of the best things you can do is feed bad clients to your competition.
6. *Revise the firm's billing and collections process.* It is time to become confident in your fees. Revise your proposal templates so that the prospect's investment is discussed first and clearly outlines when work will be billed and payments are expected, which should include retainers and progress bills. Provide a prospect one fee and stick to it; providing a range opens the door for discontent. Also include a formal change order process

in your proposals that requires a client signature before any out-of-scope work is commenced. Clients have a very short memory when it comes to remembering they approved additional fees; don't take that chance.

7. *Managing partners need to manage.* All of these suggestions require change within the partner group, and successfully creating change requires accountability. To improve realization, the managing partner needs to hold all partners accountable for implementing the change.

Improving realization will be a process, not an event. However, this process will lead to increased profitability for the firm, provide standards for billing practices, and change the culture around billings and collections within the firm. No longer should work be written off due to poor communication skills or the unwillingness to stick up for yourself. When the economy dropped, accounting firms found that they had not been managing the business of their firms very well and began to look for ways to cut the fat. As the economy turns around, it is important not to lose sight that the firm is in business and should be run efficiently and effectively. Remember, realization may just be a number, but the meaning behind the number says a lot more.

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