Industry Trends

Midyear Review: What Strategy Makes Sense Moving Forward?

By Allan D. Koltin

Q: Allan, what are the one or two biggest issues firms have been dealing with this year, and do you see that changing in the second half of the year?

A: Maybe the biggest issue is that of increasing competition. In many markets, the Big 4 are coming back to the middle market and, with that, we are seeing price wars like we've never seen before. Almost every day I get a phone call from a local or regional firm telling me about an existing client they recently lost due to price. The amazing thing is that the firm replacing them is quoting the fees somewhere between 30 percent and 50 percent below the existing fee range.

Q: Why would the "lowballer" have a pricing strategy that would cause them to struggle with making money along the way?

A: A lot of the price wars occurring today are over nonbusy-season work. Many firms have had significant layoffs of staff already. They feel that the remaining staff has exceptional talent, and they want to be available when the economy reverses itself. To do that, you have to keep these people busy, even when no consulting or special work (such as M&A or transactional work) is available. So, the alternatives are discounting work or offering seasonal pay cuts. Some firms have tried offering 10-percent pay cuts in exchange for more time off in the summer, with mixed results.

Q: What if the firm doesn't want to enter the "lion's den" and slash pricing in terms of winning business?

A: Obviously, I don't think lowballing work is a good strategy in the long run. I'd much rather see firms significantly increase their commitment to growth and marketing. Let's face it—there's still good business out there that will pay good fees and appreciate the work that the CPA firm does, but it is a little bit of a needle in a haystack in today's environment. Firms will have to market harder and more aggressively than they've ever done before.

Q: Here's a two-part question: Are clients aware of the "price wars" going on? Will this trend reverse itself after the economy improves?

A: Great questions! A recent issue of CFO MAGAZINE had as its lead article, *Auditing Your Auditor*. Essentially, the article talked about the type of "deals" that businesses were getting when putting their audit out to bid. Sadly, I believe this price war will outlive the return of the economy, and we are basically re-educating clients that "everything is negotiable." It's really a shame because we worked so hard over the past decade to bring the premium back into compliance services, and it feels like we're right back in a commodity playing field again.

Q: When the recession hit, many CPA firms had significant layoffs of entry-level staff and also cut costs in many different areas of the firm. What's next?

A: In the past couple of months, I've seen firms tackling this issue head on and having serious conversations with underachieving partners about potentially transitioning them out of the firm. One national firm in particular is rumored to be laying off almost 90 partners over the next couple of months. I think this is the next "bite of the apple" for firms in terms of tough decisions they need to make. Many firms made new partners while we were in a boom economy. Now they find that some of these partners, both equity and income, aren't meeting their required metrics. Senior managers are also being looked at more seriously, especially those who don't appear to have the potential to advance to partner. Firms are finding they can successfully push work down to the next tier. Because of this, I think we will see senior managers also transitioned out between now and the end of the year.

Q: A couple of years ago, firms seemed to be consumed with becoming "the best place to work" or the "employer of choice" firm in their market. Does this strategy still exist or has the pendulum moved in terms of the relationship between the wants and needs of the employees versus what the partners are willing to give?

A: I definitely think staff today are much more in tune with the changes in the marketplace. Many are thankful that they have a job and understand that, for the time being at least, they may have to produce "more with less." I'm also seeing firms pulling back on some of the investments they had been making in talent, both in the areas of leadership training and various benefits. My initial thought is that this may be short-sighted, and some of us are acting more like accountants than business people.

Q: Summer is a big time for annual reviews and salary increases. Will this be the year that salary increases return to "normal," or will salary (and hiring) freezes stay in place for many firms?

A: I think a good indicator of this is PriceWaterhouseCoopers, who recently announced that they have lifted their salary freeze and, instead of giving raises in September, would be giving them in July. I believe their basis for this is that private industry is again attempting to hire away their talent and they need to stay competitive in terms of pay scales. Most local and regional firms that I've talked to this year do plan to give raises, but they will be more at the two-to-three-percent level, as opposed to the five to eight percent we saw before the start of the recession.

At the same time, firms are rethinking what they do for their "superstar" associates—those people whose loss would be felt if they left the firm. I've seen firms continue to reward these individuals even if it means smaller or no pay increases for others. Anyone who's lost a superstar and felt that they could have kept the individual had they given a better raise knows exactly what I'm talking about.

Q: Is there anywhere that firms can improve profitability outside of cutting payroll costs and simply not spending money?

A: Yes, I have seen quite a few firms review their entire process for engagement profitability, starting with how they accept a client, through the budgeting and scheduling process and all the way to billing and collections. I have found that those firms willing to identify "sacred cows" and make tough decisions are actually seeing jumps in their realization along the way. Recently, I was meeting with a CPA firm and I saw a group of auditors return to the firm and head into a large conference room. When I asked the managing partner what was going on, he said, "We've decided that our auditors can't come back into the office until they finish the audit. That conference room is our staging area for work that needs to be finished immediately."

My guess is that many firms can identify great inefficiencies when they allow their talent pool to have a "start-and-stop" mentality, in terms of what they work on and how many individuals touch the work product along the way. Clearly, the strategy of "less is more" seems to have some legs, as we're finding auditors maybe preparing the tax return to a level they previously would not have thought to be their job, but now realizing it can improve the realization and efficiency on the engagement.

Q: What can we look forward to in terms of 2011 or 2012, assuming the economy improves?

A: I think the firms that make the necessary cuts and hard decisions now will uniquely position themselves not only as a surviving firm, but also as a highly profitable firm when the market returns. Let's face it—in good times we let a lot of things go and reduced the level of accountability among our partners. Great firms have clearly said that autonomy might be nice, but in today's world, we have to recommit to accountability and making the necessary tough decision to survive and ultimately thrive into the future.

Editor's note: If you have any questions about this article or any other issues facing your firm, please feel free to contact Allan D. Koltin, CPA, CEO of PDI Global, Inc. and a founding member of The Advisory Board, at *AKoltin@pdiglobal.com* or 312-245-1930 and *Marsha.Leest@WoltersKluwer.com*. We welcome your input and ideas and we hope you will continue to look to CPA Practice Management Forum for guidance and best practices. ✦