SUCCESSION+

Professional Services Business Model for 2030

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We work with a large number of professional services firms and as they get larger, we often see a repeated pattern of behaviour – behaviours which turn them from a small, agile, profitable business into a slow, bureaucratic, cost heavy dinosaur.

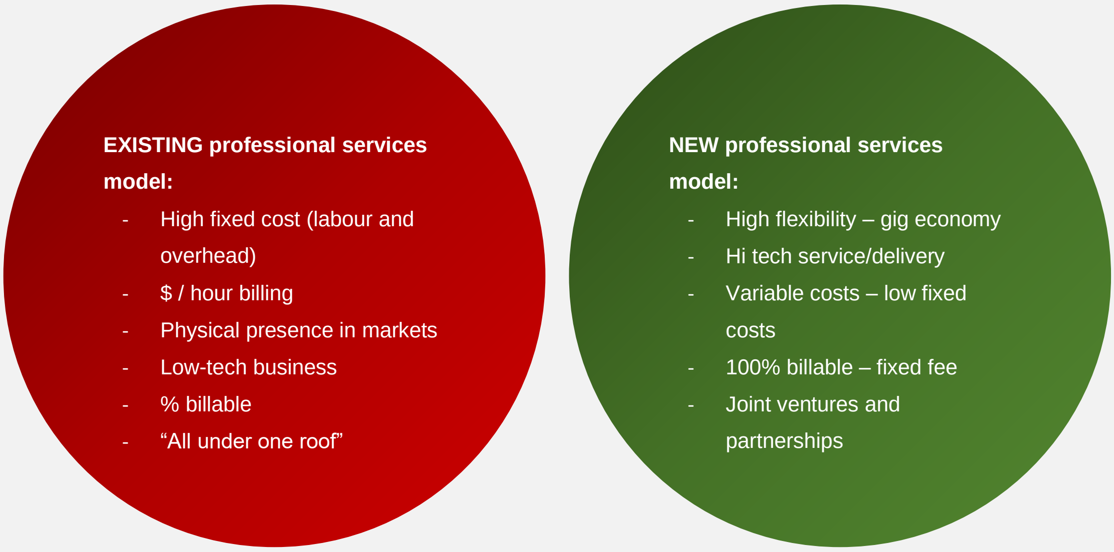
My clients will tell you I am known for direct, clear advice – well here it is:

- The end of the month occurs at the end of the month. The number of firms who create month end to suit some arbitrary timeline amazes me and no-one can sensibly explain why.
- Firms should invoice their clients as soon as work is completed (even better upon acceptance of the proposal/interim invoices or regular monthly instalments). Why do we wait until month-end and race around like lunatics trying to work out what to invoice?
- Work in progress (WIP) is like your stock. Imagine if inventory were to be stolen, written off, lost, or worst of all, sent out without ever charging for it, yet all of these happen quite often in a professional services firm.
- The power of an hour – each hour worked has only three possible outcomes – multiplier (by producing and invoicing billable work at a higher rate than cost), neutral – non-billable (admin etc.) time and the worst scenario – divider – work on a project or job then write the time off.
- Profits are the result of doing everything else well.
- Positioning is a vital skill – marketing and promotion as a GP is not great positioning – if you are a heart surgeon – you need to own Thought Leadership in that space!

Given that you are most likely in professional services and love understanding the detail behind these key points, please check out some of the critical factors below.

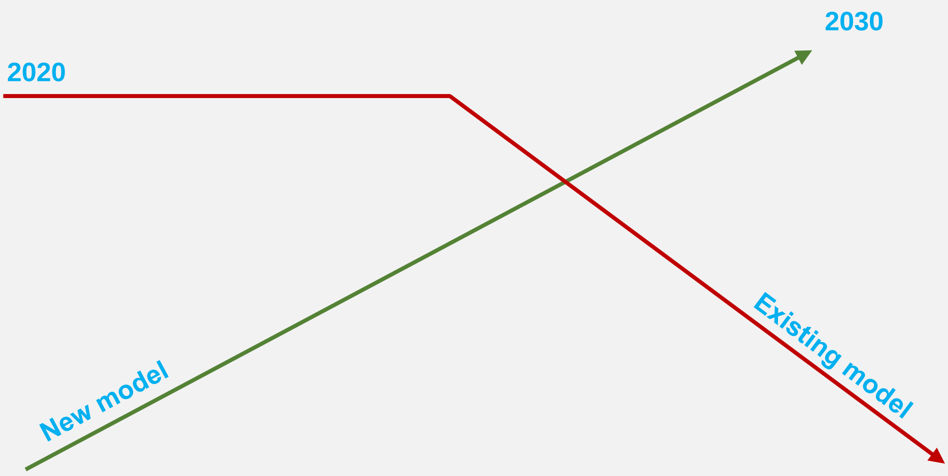
An Improved Professional Services Model

The current professional services model is familiar and mastered by most; however, it may no longer serve us in the next ten years.



The greatest threats to professional services firms’ livelihood are very low revenue growth between 2005-21, with this trend expected to continue to 2026, and very high competition, with 225,000 businesses currently in the professional services realm nationally (Baikie, 2020). To remain afloat, professional services firms must remain competitive by evolving with client needs and increasing productivity and profitability. This is especially important in an increasingly saturated market.

Two key areas professional services firms must focus on improving are productivity and profitability. Productivity entails systemisation, documentation of operation manuals, increasing internal efficiency, outsourcing non-core business functions (including offshoring) and digitisation and automation. Profitability will improve by increased productivity, lowering fixed costs, increasing flexibility by hiring gig contractors, implementing a zero-write-off policy, and building new joint ventures and partnerships.



Productivity	Profitability
Systemisation Documentation Digitalisation and Automation Outsourcing	Low fixed costs Flexible services Zero-write-off policy Digitalisation and Automation Joint ventures and partnerships

Productivity

Productivity is arguably the most important aspect a firm must have to be profitable. Most firms invest vast amounts of time and money in measuring time, billable time, non-billable time, strategic time, time write-offs – what a waste of time! There are many areas of improvement in professional services firms to increase productivity. In order to maximise productivity, firms must: integrate more technology in day-to-day operations, develop and perfect internal systems and processes, document (and follow) procedure manuals, digitise and automate, and outsource non-core functions.

In the current Digital Age, technology must be utilised to its fullest extent to improve internal efficiencies. The ongoing pandemic has emphasised the need for firms to evolve with the development of technology.

Most business leaders are aware that documenting procedure manuals and implementing effective systems will dramatically improve internal efficiencies and streamline operations; however, most firms have yet to master this (David Kaesehagen – Ecoscape Australia). A large portion of a mid-market firm's intrinsic value is in the knowledge each employee and owner hold. If any were to leave the business (by choice or force), this value will leave with them. Hence, it is extremely important to document *everything* (Cassin, 2015).

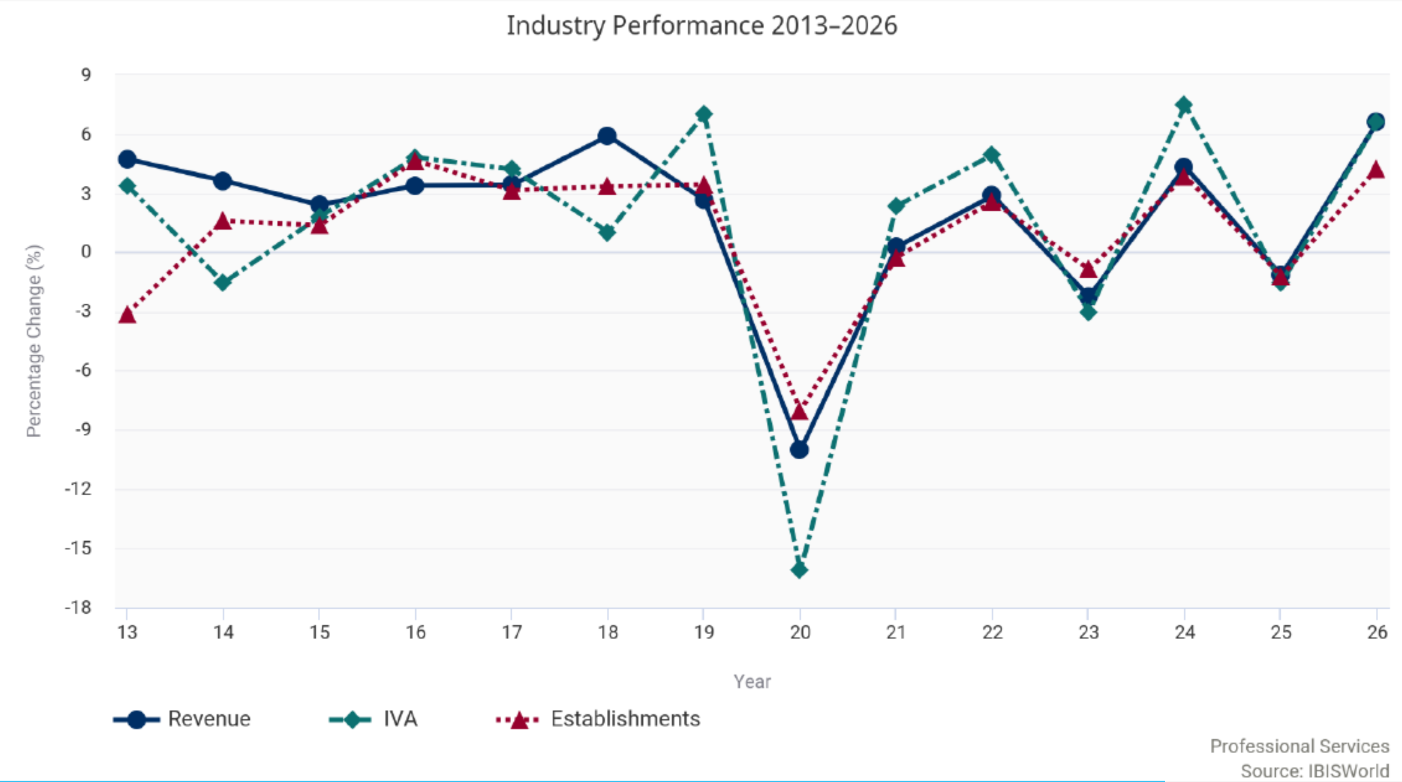
Perfecting systems and processes and ensure you have a good team to streamline pipeline of work (David Kaesehagen – Ecoscape Australia). A common issue amongst many professional services firms, especially financial planning and business advisory firms is that they rely on often unresponsive clients providing data for provision of services. This is often an overlooked, although substantial, cost to productivity and profitability (Rob Pyne – HPH Solutions). The longer clients refrain from providing data, the longer they sit in inventory/WIP, reducing efficiency and liquidity.

Outsourcing non-core functions will also improve productivity. Non-core tasks that technology cannot perform must be outsourced to cut costs and free up time for professional employees to focus on meaningful work (Ruthven Institute, 2019).

The Pareto Principle states that 80% of results stems from 20% of actions. I like to look at this with even more focus - 4/64 (80/20 on 80/20 produces 4/64). Many non-core business activities such as administration are time consuming – drill down and find the 4% of activities that can produce 64% of results. So, I would encourage readers to reflect on this question: *What do you spend your most critical time on and does that create 64% of results?*

Profitability

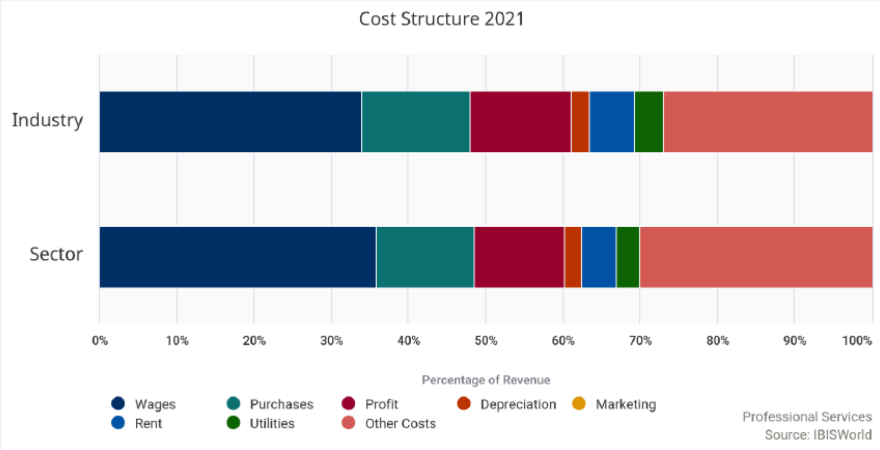
Declining profitability, profit margin squeezes and a low revenue per employee pose as some of the most significant threats to professional services firms' livelihood. Profitability among professional services firms nationally have declined at a steady rate of 2.9% over the period 2016-21, with the current profit margin being 13.1% (Baikie, 2020) – almost 9% lower than the World's Best Practice of 22% (Ruthven Institute, 2019).



Profitability is the result of running your business effectively and productively (Collins-Woolcock, 2020). Additional to the points under productivity, key areas that professional services firms could adopt are outlined below.

Automating and digitising. Not only do these increase internal efficiencies, but also impact rising wage costs. Professional staff wages have substantially increased over the past five years to over 40% of gross fees, further squeezing profit margins (Mark Pinhorn – HYD Advisory). Moreover, technology will conduct repetitive and time-consuming tasks in a much shorter time and with a higher accuracy rate than humans. This will significantly save the cost of correcting mistakes and wage costs, which forms the majority of expenditure within professional services firms (shown below) (Baikie, 2020). Utilising technology more extensively in business operations could increase EBIT, allowing the business to compare to industry benchmark firms (Michael Bova – Family Wealth Advisory).

Cost Structure Benchmarks



Firm expenditure should largely comprise of variable costs and low fixed costs.

The government-mandated quarantining and social distancing due to the current pandemic has popularised contract-based work (Ruthven Institute, 2019), which works in professional services firms' favour.

Maintaining good relationships with profitable clients is also crucial. In simpler terms, *give them what they need, not what you want to provide* (Alan Rich – Clarion Group).

Joint ventures and partnerships can be highly beneficial and profitable. Many professional services firms, especially mid-market ones are looking for innovative and lower risk ways to expand. Joint ventures and partnerships are a smart way to expand without requiring a sizeable amount of capital expenditure. Expansion will allow the business to have a wider geographical footprint, sector diversity and clientele.

A significant reason professional services firms must employ efficient systems and procedures in managing clients is to avoid write-offs. Why on earth would it ever be acceptable to write-off our time on a project? Imagine a plumber repairing your faulty tap and then not charging for time because it was hard to access!

Tips to Avoid Write-Offs

Ensure the job scope is 100% correct	• Describe the tasks required to complete the job in detail
Project management	• Manage workflow and processes consistently throughout the project
Ensure employees are trained on profitable jobs	• Employees are often a business' greatest asset. To ensure a valuable return on this asset, they must be able to perform profitable jobs well
Zero-write-off policy	• Set a write-off target/budget • Implement a retainer or a strict zero-write-off policy
Regular updates on ongoing jobs	• Open communication and regular reporting *throughout* the project • Utilise a project management software to streamline this process

Leading Profitability Framework

It may be helpful to know how Australian businesses compare to the World's Best Practice (WBP) Profitability (return on shareholder funds after tax (ROSF)) benchmark. The current WBP Profitability is 22%. However, in 2019, the 2.4 million businesses actively operating nationally generated a low average profit of only 3% for over 30 years. Furthermore, 43% of Australia's largest businesses generated less than the historical 10-year Bond Rate of 5.5% (over the past 30 years) or ran at a loss. By comparison, private sector corporations and financial corporations nationally generated an average profit of 6.1% and 6.9% respectively (Ruthven Institute, 2019).

Illustrated below are the 12 Golden Rules for Success (sourced from the Ruthven Institute) businesses can adopt to improve profitability.

Businesses which follow all or most of the 12 rules are more likely to generate higher profits than businesses that do not. The most broken success rules are focus on one business at a time, emulate WBP, and be the master of your own destiny. 13% of Australia's largest businesses achieved or surpassed the WBP of 22%, indicating that this benchmark is doable – or for mid-market professional services firms, something equivalent to 22% is doable after running the business effectively and efficiently.

Expert opinions from our network

Prior to completing this whitepaper, I asked several respected advisers and business owners in our network for their key thoughts on professional services firms for the next decade:

According to Roger Collins-Woolcock, profitability is a result of running your business effectively. In the real case of Cardno, Business Units which scored the highest in terms of profitability also scored highest in areas of clients, growth, people, quality, safety, management and performance. This dictates that the best businesses: have flawless systems and processes which means regular career review feedbacks; have low staff turnover; engage with the marketplace and clients for continuous growth; actively chase debtors; produce diligent timesheets, regularly request feedback from clients; utilise safety and quality systems; employ effective management tools which proactively resolve early signs of issues before they fester; engage with referral partners to gain clients without spending excessively on marketing; and focus on being market-facing.

Natasha Hawker, founder and managing director of Employee Matters, voices her insights on what professional services firms must improve on. The high cost of wages compared to the amount that firms can charge for their service negatively impacts profitability. Therefore, businesses must work on providing higher value services and also better articulate their value proposition to remove client anxiety surrounding seemingly high prices. Furthermore, more firms should seek client feedback more frequently to better employee performance and better address client needs.

Natasha passionately promotes employees as a business' most valuable asset. Hence, employees must be well-trained and closely managed through a comprehensive and effective performance management system. A modern performance management technique should encompass recognition, reward, competency development, two-way feedback, and career development (Cassin, 2015).

Natasha says that SME's must pay more attention to the-long term, rather than solely on short-term strategic business plan to ensure business sustainability. Imperative to ensure sustainability, profitability and success are ensuring a competitive edge, managing costs and building a cash reserve. Employees (some or all) must be privy to this long-term sustainability plan– without letting your team know where the business intends on heading, how can they help you? To motivate employees to achieve these strategic business goals, they must think and act like business owners.

Steve Champion of ER Strategies says that businesses must specialise in what they perform well rather than being a 'Jack or Jill of all trades.' This is how mid-market firms can compete with larger firms with more resources. Firms must therefore specialise, build core competencies in potential growth areas, and continually innovate in one focus area and focusing marketing efforts on this area. Staff development and retaining key employees are crucial in pursuit of specialisation. Steve says that employees must be incentivised the correct way through implementing an effective renumeration strategy. Furthermore, he believes that the ESOP implemented in his business is 'a key part of … rewarding … staff for treating the business like it is their own, which can also be critical to business success.'

Jamie O'Rourke, National Chairman of RSM Australia, outlines key strategies in terms of profit and performance within professional services firms. The first is leadership alignment; leaders must agree on and work towards common strategies and goals to maximise the chances of achieving the agreed upon goals. Secondly, servicing and maintaining a good and profitable relationship with clients are more important than ever during these times. Times of uncertainty give rise to hesitations of the value of services provided and leave clients wondering whether the money they have invested in firms provide worthy returns. Thirdly, firms must focus not only on clients, but also on people development and staff engagement. An engaged, well-trained and professional workforce ensures that the business evolves with and serves the needs of clients. Businesses must also be agile and innovative – they must be prepared to overcome any disruptions by working with new technology to ensure the business will not fall behind despite any intervention. Finally, firms must focus on company culture – everyone must have common beliefs and a unified purpose. The business' vision and mission must be reflected by employees.

Conclusion

Professional services firms must develop their business model over the next ten years to remain competitive. Evidently, the greatest threat to these firms is decreasing profitability. The Professional Services Firms Model for 2030 focuses on improving productivity and profitability as these are arguably the most crucial aspects to business livelihood and success. The paper also outlines a leading profitability framework and expert opinions which business leaders can adopt to improve their business operations.

Special Thanks

Thanks to the following professionals and business owners who were quoted throughout the document:

David Kaesehagen – Ecoscape Australia
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Michael Bova – Family Wealth Advisory
Alan Rich – Clarion Group
Natasha Hawker – Employee Matters
Steve Champion – ER Strategies
Jamie O'Rourke – RSM Australia

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