The Professional Services Paradox

For most professional firm leaders, financial discipline is at best secondary to their core expertise. Many firms led by brilliant specialists hit a profitability ceiling because financial strategies are overlooked in the pursuit of client service and engagement success. Maximizing potential and profitability requires a strong reputation for ability and innovation, but also demands a commitment to financial discipline.

Read on for a roadmap that identifies three proven strategies that can help professional services firms get their financial houses in order.

1. Tighten the liquidity reins

Even the most profitable professional services firms can face cash-flow issues. For some professional industries, revenue is cyclical; for example, accounting revenues peak in fall, winter and early spring and trough in the summer. For others, the cycle is driven by reduced business development activity that typically correlates with high partner billability on current projects. The busier professionals are, the more likely their pipeline of future business is weak.

A lack of discipline in billing and accounts receivable processes can expose a firm to unnecessary liquidity and working capital risk. Left unchecked, these risks can reduce a firm’s creditworthiness, which can limit access to capital when needed. Firms can strengthen liquidity by adopting good financial housekeeping standards. Ensure timely billing, and hold partners and associates accountable for prompt time and expense reporting. Articulate and clearly communicate the risks of noncompliance.

Cash management technologies can automate payments and receivables and generate detailed reporting that makes monitoring and management of cash flow easier. Professional services firms can benefit from:

• Leveraging lockbox services to speed payment processing and improve back office efficiency at the same time.
• Replacing paper check use for payments with faster and more secure ACH capabilities to allow more precise management of payables, reducing working capital requirements without increasing demands on finance staff time.
• Enabling payment by credit card, which can both deliver faster and easier access to funds and reduce collections problems.

2. Apply best practice financial planning and reporting

Professional firms often find the discipline of long-term planning difficult. The topline drives the forecast, and many professionals would say revenue growth depends heavily on luck. A key client can be acquired and a long-term revenue stream evaporates; alternatively, a run of transactions in which the client is the acquirer – or even simply a promotion for a key executive – can suddenly drive double-digit growth. While the prospect of these events is real, it is impossible to achieve a plan without documenting it.

The COO or CFO can introduce the strategic tool of financial planning, facilitating the development of a range of scenarios from conservative to ambitious.

Following through on a strategic or financial plan is as important as creating it. Establishing a reporting discipline that matches the goals of the plan is key to success. Many professional services firms evaluate financial performance based mainly on whether partners and producers meet their revenue goals. But this topline approach can mask important measures of success – most importantly, revenue realization and efficiency.
3. Build growth plans on the right financing

Not all professional services growth can – or should – be financed organically. While care should be taken not to overextend, financing strategies can both protect and enhance a professional company’s growth success. Firms that have demonstrated sound financial management practices are more likely to obtain the right type and level of credit on attractive terms from a wider range of lenders.

A plan is only as good as its process and assumptions, and the following should be considered:

- **Make it collaborative.** Apply an iterative top-down and bottom-up model to achieve the best forecast; more accurate numbers are likely if the views of individual practitioners are filtered through historical facts. Engaging executives who are responsible for delivering against objectives in the development of the financial plan is required for a plan to work.

- **Avoid the single basket trap.** Ensure that the firm’s growth plans avoid client, practice or even segment concentration, avoiding the lure of higher profit or growth potential in specific areas. Becoming increasingly focused on areas that deliver higher return can leave a firm too exposed to the risk of sudden change.

- **Strive for the best, but plan for the worst.** Articulate specific plans for contingencies; develop both revenue replacement and cost containment strategies for quick response to a sudden departure of a major client or partner, and on the other side, outline how the firm would address unexpected new growth, including plans for and cost of using temporary staff.

While the cost of borrowing is always an important consideration, the key factor for choosing any particular program should be its intended use:

- Leasing is a strategy well-suited to financing technology purchases for professional firms, as it preserves capital and can offer tax advantages.

- A line of credit is a good choice for working capital or unexpected financial obligations. For example, lines can provide flexibility to address short-term cash requirements created by partnership retirements, severances or even unexpected collections issues.

- Business loans are appropriate for funding long-term expansion plans, such as practice acquisition, new office openings or even broader staff growth.

- A financing strategy for mergers or acquisitions must carefully address compensation, tax and accounting issues and may include a range of debt and equity solutions in the new capital structure.

Most important, professional firms need to make sure any borrowing is necessary, and that credit lines and borrowing capacity are adaptable to accommodate rapidly changing needs.

Today’s most successful professional firms are looking to finance as a strategic weapon. Increasingly, professional services firms recognize the need for strong liquidity management, a disciplined financial planning process and a thoughtful approach to financing growth. Those who apply these financial strategies continuously and deliberately will find they contribute measurably to the bottom line.

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Citizens Commercial Banking has been a leading provider of specialized banking services to professional firms for more than 30 years. Our bankers are focused on serving professionals, so understand the unique cash flow, staffing and time management challenges of client-driven businesses.

Combining deep knowledge of professional services needs with a broad array of products – from loans and leases deposit and treasury management products – enables customized solutions to help professional firms grow and prosper.

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