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Seven keys to success in professional service businesses

Professional service businesses, or client service businesses, offer the ultimate in flexibility. There is no standardised product: the product is whatever the customer wants. There are no price lists: the price is negotiated on a project-by-project basis.

The management of costs is similarly complex: unlike a manufacturing company which can track materials into and out of stock and out of the warehouse to the customer, the client service business' overheads are typically the costs of its staff, which are difficult to track and manage across various projects.

For this reason the financial management of a professional service business can be extremely difficult. Get it right and the rewards can be astronomical; get it wrong and you can be working very hard, doing good work – and going out of business.

Here are seven ways you can ensure financial success:

1. UNDERSTAND THE 'WHO' AND THE 'WHY' OF CUSTOMER PROFITABILITY

You can manage the business effectively only if you have accurate and timely information on the profitability of individual projects and of customers.

You need to understand which of your customers are most profitable and which are losing you money – and *why*.

In examining the *who* of customer profitability, the 80/20 rule applies: 80% of your profits will come from 20% of your customers, 80% of your problems and losses will also come from another 20% of your customers.

Understanding *why* is even more important. Why are some customers more profitable or less profitable than others? It may be that some customers simply don't see the value of what you do, but see you as a commodity supplier, not as a valued partner. Customers like those aren't difficult to spot. They change their suppliers regularly by means of competitive tenders, they employ professional buyers to beat suppliers down to the lowest price and they avoid establishing long-term relationships with particular advisors.

Or perhaps account management problems are depressing the profitability of some customers. Some clients are just inherently difficult to deal with: they keep changing their minds, they never seem to know what they want or they are very bad at communicating it, they don't plan well so they are constantly asking for rush-jobs, for timetables to be accelerated or for extra work to be squeezed in at the last minute.

Another reason for low profitability may be that you are doing the wrong sort of work. Very often, firms under pressure to increase revenues go after work which is not in their core area of expertise Once they win it, they find they are not equipped or staffed to deliver well. Operating outside your core area of expertise in competition with suppliers who are better equipped to deliver in that area is a no-win situation.

Understanding why work is unprofitable will help you to rectify it. If you are dealing with a 'commodity buyer', the first question to ask is "are we a commodity or not?" Do we offer a superior service and if so, can we convince this client of its value?

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If you can, all well and good; but if not, such business is probably never going to be profitable for you as providing superior-quality work inevitably entails higher costs. If you are competing against lower-quality suppliers for a client who really doesn't care about the difference, you will never be competitive; and the only way you can win the business is by accepting sub-standard margins. In this case, lower profitability indicates you are playing the wrong game.

When dealing with the 'nightmare client', you need to understand why they are a nightmare. Is it the way you handle them, are they just inherently disorganised? If it's the former, then there is something you can do about it; if it's the latter, then you need to raise your prices.

There are clients who simply don't know how to make the best use of their suppliers. You need to find a way of making the client understand that the way they work with you has a substantial impact on your costs and therefore on what you need to charge them. You may even be able to turn this to your advantage if you can show them the value of having you regularly saving them time and trouble.

If you find you are unprofitable in a particular activity, you need to be getting out of that activity. You may be able to justify it if you are doing a small job for a valued client, but very often it will come down to a decision: are you willing to do what you need to do in order to organise yourselves for this new line of work, or should you avoid it?

This seems so obvious. Why do so many firms burden themselves with unprofitable projects and difficult clients? Often, it is a question of information. Most people have strong suspicions about where the problems lie, but can't prove it. It is difficult to say "we are going to fire this client because they are losing us money." It is easier to say "we are going to fire this client because their profitability over the last five projects is 35% of our average and only 70% of the minimum acceptable."

Information enables action.

2. HAVE A PRICING MODEL AND USE IT

Most professional service businesses use either a time-and-materials pricing model or a fixed-price method. You may charge each month based on the time spent on a project at an agreed rate, or you may agree a fixed price for a project. You need to know whether your pricing model reflects the value you are delivering to clients and whether it is actually profitable.

Often the value of your services to the client is not a function of the number of hours you work or the costs you incur. It may be your superior knowledge of a particular field which enables you to complete work more accurately and/or more quickly than your competitors. It may be your contacts enable you to open doors for your client which would otherwise remain firmly closed. It may be your ability or your willingness to work all night to get them out of a tight spot.

Many pricing models are unable to capture these examples of value to the client. It makes no sense to work hard at increasing the capabilities of your firm if you then settle on a pricing model which never earns you more than cost plus a certain percentage, as many pricing models do.

Your pricing model obviously needs to be aligned with your firm's need to make a profit. Often people are incentivised to generate revenues but the profits those revenues actually produce are never calculated or monitored.

3. KEEP CONTROL OF PRICING

There is no point having a value-based pricing system which generates the required levels of profitability if it isn't

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actually applied. Usually it's not too difficult to apply a pricing model in the early stages of a proposal; the problems usually arrive in the closing moments. Canny buyers know a very good technique for achieving a reduction in price: they lead the supplier along and then, at the very last moment, suddenly turn round and ask for a reduction. In the heat of the moment when everyone is already counting on the sale, it can be very difficult to hold the line on pricing.

At such moments you need senior-level control of pricing decisions to avoid reducing your profit margin in the closing days of a sale.

4. CAREFULLY MANAGE NEW-BUSINESS ACQUISITION COSTS

In many cases, as much time, effort and cost go into *winning* business as into *delivering* it. There is nothing wrong with that, provided the business won is sufficiently profitable; but the costs of acquiring new business need to be carefully managed to ensure they provide adequate returns.

I have seen cases where so much has been spent on the proposal that the project was sure to lose money, however well it went. You need to establish some sort of guidelines for new-business acquisition. There are a number of factors to consider when deciding how much to devote to a new business proposal:

"Is this one project or is it a new customer relationship? Realistically, why has this potential client come to us? Are they looking for a new key supplier? Does this offer the chance of a longstanding customer relationship or are they just looking for a one-off?

Maybe they are happy with their existing suppliers but need someone else to do a particular, specialist piece of work. You need to look beyond the first sale at the prospects for future work when deciding how much money to devote to a project.
"How much is this customer relationship likely to be worth over its lifetime? How much do you expect to make in the first year and subsequent years? How many years do you expect this customer relationship to last? Does this potential client have a track record of staying with suppliers or do they frequently change them?

"How realistic is this opportunity? Is this prospect genuinely looking to start working with a new supplier? Perhaps they just want to shake up their existing suppliers in order to obtain lower prices. Maybe they are required to go through the motions of getting three tenders for a particular piece of work but have already decided who they want – and it's not you.

I remember one case where my company put huge amounts of time and effort into a new-business proposal and we were then astounded to hear that one of the other bidders had faxed in their proposal. We didn't get the business and neither did they, but I suspect they had a better understanding of what the real prospects were. It was a stitch-up, and they weren't wasting much time on it.

All this is a way of assessing lifetime customer value: how long, how profitable, how likely? The assessment is of course very imprecise, but you must make it before you decide how much time and effort to invest in it.

5. UNDERSTAND THE VALUE OF CUSTOMER LONGEVITY

It's a truism that existing customers are more profitable than new ones. It's much easier to sell additional work to an existing client than it is to acquire a new one.

Projects run more smoothly as you know the client better. Their confidence and trust in your company can enable you to charge higher prices and achieve better margins.

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Customer longevity is not an accident. Customers stay with you because you work to keep them happy, which means looking beyond the work you are doing for them to the relationship. You don't need a sophisticated financial model to see that, pound for pound, effort spent on *retaining* clients pays more than effort spent on winning *new* ones. But how many firms allocate their efforts in ways that reflect this?

6. KNOW THE PROFILE OF YOUR IDEAL CLIENT

By now you should be in a position to start forming a picture of your ideal client. They appreciate the value of what you do because they deal with you regularly over a number of years. They want the sort of services you are set up to provide. It's not too difficult to articulate the type of client you want, but what can be more revealing is an analysis of your customer base, to see what proportion of revenues actually come from clients who approximate your ideal. It could be surprisingly low.

If it is, there are quite a few things you need to do. Firstly, ask yourself if you have communicated to everybody in the firm the sort of clients and client relationships you are looking for. Does everybody who is looking for new business understand the type of client that works well for you and the ones that don't? Are you sufficiently discriminating in the early stages of the new-business process to concentrate your efforts on acquiring the sort of clients you really want?

If you are struggling to meet revenue targets by servicing clients that don't fit your ideal-client profile, perhaps you should ask yourself whether you are competitive in your chosen niche. Maybe, as you are currently organised, you are not well equipped to bring in the sort of work you really want. Maybe you need to get rid of some clients. This may sound like 'heresy', but very often it can be the best thing to do. Poor-quality clients can put an enormous stress on the organisation – they cost you money, they depress morale, they prevent you pursuing better opportunities. If poor profitability can't be remedied, the client needs to go – and you'll be amazed at the energy and enthusiasm their departure releases for finding better business.

7. THINK ABOUT CASH-FLOW

Profit is just a fictitious number arrived at by accountants through an arcane route. What actually keeps business in business and gives you the ability to do what you want to do is cash in the bank. It's very easy to make – or to *manufacture* – profits without generating the cash you need.

Ensuring a robust cash-flow can be particularly complex in client service businesses where issues of non-payment are often due to account management problems, problems with the client relationship or disputes over the quality of work. Ensuring a robust cash-flow requires much more than chasing outstanding invoices (although that can be a very good place to start).

Ensuring a robust cash-flow requires action throughout the organisation, starting from before the sale. Contract terms, payment periods and payment milestones are all crucial. Allocating responsibility correctly is also key – you can't have people from the accounts department trampling on important client relationships if payments are late, but somebody needs to take responsibility for resolving those issues.

The impact of effective cash management can be dramatic. One company for which I worked financed itself almost exclusively through advance payments from customers. In the very early days we had a bank overdraft which peaked briefly at about £250,000; but we soon repaid that and replaced the overdraft facility with

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money from customers which at one point amounted to almost £1 million in the bank, for work yet to be done!

SELF-BELIEF – WITH GOOD INFORMATION

Success is the outcome of belief in yourself, backed up by good information and management processes.

You must believe you can really make a difference for your clients, and be rewarded accordingly. You must have pricing models to ensure you are properly rewarded, and management processes to make sure pricing models are applied.

You must believe you can win work from the type of clients you want and can make a good living working with them. You must have information to tell you whether you are doing this or not.

Akenhurst Consultants can help you to improve you profitability without painful cost-cutting. If you would like to discuss how the concepts and techniques described here could help your business, please contact Alastair Dryburgh.

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