Making Money in CPA Firms in These Turbulent Economic Times

by Gary L. Adamson, CPA

The universal measure of profitability in accounting firms is average income per partner. Another universal tool is the annual Rosenberg National MAP Survey. It's a must have for running your firm. In the 2010 survey, Rosenberg identifies his "Elite" firms which are the 54 who had income per partner of over $500,000. Not bad considering it is based on 2009 economic data in the middle of the recession.

It's interesting if you dig into the data in the survey you will find that these 54 aren't just the biggest firms although as Rosenberg puts it, bigger is better in terms of profitability. In fact 24 of them are in the $2-$10 million fee range and three are sole proprietors.

I want to focus on two measures in the survey where the most profitable firms really make their money: partner to staff leverage and overall net firm billing rate. The 54 top firms had a leverage ratio of 7.7 to 1 compared to 4.9 to 1 for all 425 firms in the survey. Wow! The net firm billing rate for the top 54 was $157.80 versus $136.63 for all firms. Remember that the overall survey averages include the top 54 which means the gap between them and everybody else is actually wider.

The leverage ratio which is also illustrated by net fees per partner is pretty easy to understand. Clearly the fewer owners that you need to service a given amount of client revenue, the more you will earn per partner. The top 54 firms have figured out how to do that. As a managing partner, this is not a statistic that is easy to change but it should always be on your radar screen and it has the most significant impact.

When most of us think about the second statistic, overall net firm billing rate, we automatically jump to the assumption that the most profitable firms have the highest billing rates and "we can't get there because we just can't raise our rates that much". Not so fast. The Rosenberg survey included 40 firms with over $20 million in revenue and the average partner billing rate for those firms was $356. The average partner billing rate for the top 54 was only $324. So what else is going on with those top 54 firms?

The answer is that a firm's billing rates are only part of the equation. The net billing rate is a mathematical expression for a number of things happening in your firm. Yes, it is total billings divided by total charge hours. But how do you maximize the billing number and minimize the hours? All of these factors are part of it:

- Billing rates
- Mix of staff on the job (proper leverage)
- Efficiency – use of the firm's technology, efficient work processes and review, minimizing stops and restarts, etc.
- Scope creep – are you controlling it and getting paid for it?
- Type of work – audit vs. tax vs. consulting. Are you billing what the market will support?
- Fixed fee?
- Work budgets
- Who are the billers and what are their billing philosophies?

All of these have an impact on your net firm billing rate. As managing partners we should be looking at all of these and ways to make incremental improvements. If we do, it can add up to significant strides in improving our overall net firm billing rate and the ultimate goal, our average income per partner.

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