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Value comparison of acquiring fees vs. Investing in 10x

So you're looking to grow your firm. In these times of economic uncertainty, it pays to weigh up all of the options before making a decision you may later regret.

This report examines three distinct options open to you, examining the pros and cons of each.

We will consider:

1. Acquiring another accounting firm (or a block of fees)
2. Acquiring or starting a financial planning division
3. Bolting on a specialist business coaching division through the acquisition of a 10x franchise.

Clearly in reading this report you only get our bias but we hope that by the time you get to the end of the opinion, you'll appreciate the different arguments and discussions put forward and that we've given you some more insights that will help you make the right choice to move your business to the next level. We also aim to provide you with some value that you can implement straight away, no matter where you are at with your growth plans.

We'll start our discussion by taking a look at a position we have heard a lot of recently. There is a lot of merger and acquisition activity in the accounting industry currently with speculation that consolidation is about to be stepped up with a significant reduction in the number of firms over the next ten years. As a result, many firms are contemplating acquisition as a means to grow.

Before we get into our analysis of each alternative, let's review the state of play in the profession.

Partners in many public accounting firms are making more money than they ever have before. Australia's complex tax system and frequent changes to legislation continues to place increasing burden on small to medium sized businesses. The accountant, as the most trusted advisor, is the professional to whom business owners turn for help and advice. As such, accountants have an abundance of work. Servicing, rather than finding new work, is the challenge.

This started with the introduction of GST in Australia in 2000. As expected, this was – and continues to be – a goldmine for accounting firms. Unfortunately, it has taken eight years for the profession to realise that all that glistens is not gold, as many firms find themselves now more mired than ever in compliance.

This challenge is exacerbated by the ever tightening labour market. Australia's booming economy has placed tremendous upward pressure on salaries. Graduates are staying with firms for a year, then leaving for commerce, demanding twice the salary they were paid in practice.

Accounting firms are reluctant to meet the market at that level as they do not see skills and expertise commensurate with such a salary demand.

Further up the chain, senior accountants are very aware that they are marketable knowledge workers. That, coupled with the Gen Y phenomenon that so many mature practitioners find hard to deal with, has resulted in senior accountants becoming transient. We therefore find ourselves in a negative spiral, where employers in public practice are reluctant to pay recruitment fees because they are paranoid that they will invest in a senior accountant for a year only to then lose them.

This is a classic case of focusing on the wrong thing. Perhaps it's not the labour market that is the problem. Perhaps the real problem is that we are offering an environment that is stale, lacking in opportunity, bereft of variety and, frankly, a monotonous bore for progressive young people. It's time to look within our profession for a solution.

Think about the last time you tried to hire a senior accountant. How did your advert look? What were the words you used when you interviewed the candidates (if indeed, you generated any candidates)? What impression did your office environment and your team leave on them? Was it something like this:

"Wanted - person to work 60 to 80 hours per week from August to November (the remainder of the year is only 40 hours per week). The work you will do for the first one to two years will be dull and mundane and have few challenges to your intellect. We will pay you pretty well and give you as many benefits as most other places, but in return you must account to us for your day in six minute increments. How many of these six minute increments you can charge to our clients will determine your worth to the firm. We do not want your creative thoughts; we just want you to charge as many hours as possible because we have not bothered to come up with a more creative way to bill our clients."

It's hardly inspiring, is it?

The challenge we face is to CHANGE the formula. And what makes it harder is we need to change to a winning formula – one that is delivering strong profits per partner. Clearly, such a strategy is fraught with risk, but the alternative is to keep doing the same things and hoping it will get better. There is little to suggest that it will, which will lead to partners being forced to spend more and more chargeable hours themselves on low value work, ultimately diminishing returns and stymieing growth.

With that background in mind, we will begin on our discussion of growth options by examining the argument for acquisition.



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1. Acquiring another accounting firm

Let's begin by examining the landscape of accounting firms around the world, building on the state of the nation outlined above. Here is a dose of reality: despite pleas from virtually every firm we speak with that 'we are different', the fact is that most accounting firms are absolutely the same. They are doing the same kind of work with the same kinds of clients, using the same kinds of people. Their offices look and feel the same. Their key challenges are all the same. And not surprisingly, their financial results are remarkably similar. Naturally, there are a small number of firms outperforming the rest, but there are many, many firms doing average things and getting average returns.

So if most firms are very similar, in theory that means that an acquisition target is likely to have the same organisational, people and operational challenges as your own firm. So the quid pro quo in exchange for increasing your fees and your client base is that you wind up bolting on more stress and administration.

We recently conducted a survey of 66 firms whose only common bond was that they had elected independently to attend a seminar purporting to provide them with solutions to build a successful accounting business. By definition, the firms attending presumably had ambitions to grow. It's a decent sample size and useful for this purpose by virtue of their being qualified as ambitious firms. Here are some key numbers collated from the sample:

Median number of partners per firm	2
Median number of additional team members per firm	6.6
People per partner	4.8
Average hourly rate recovered (based on client hours only, after write offs)	\$126
Median EBIT before partners' salaries (per partner)	\$211,500

Only 12 of the 66 firms reported profit per partner in excess of \$400,000. Four had profit per partner in excess of \$750,000. Interestingly, of those four, three were sole practitioners.

The rest of the sample were much of a muchness, with partners on the whole working long hours for returns barely in excess (and sometimes much less) than they could earn working for someone else.

Average EBIT before partners' salary tracks around 30-35% (largely because of the 1/3rd, 1/3rd, 1/3rd price setting policy to determine charge out rates) although we see these diminishing as many firms are not game to pass on significant increases in salary costs to their clients.

So, back to the acquisition strategy. In all likelihood, the most predictable outcome of acquiring another firm is that, at best, you bolt one mediocre firm onto another, resulting in distinctly mediocre results.

There are very few, if any, economies of scale in this business. Firms often eye acquisition targets with plans to take on the pick of the clients and the best team members from the target firm. Yet when it comes to the crunch, the turbulence of an acquisition can unsettle team members and, perhaps not surprisingly, it's often the strongest ones, knowing their worth in the market place, who choose to jump ship, leaving you with an uninspiring talent pool.

If you are a high performing firm, there is a strong argument for acquiring another firm, since you can take the strategies you've implemented in your own firm and leverage them into the acquired firm. Firms following this strategy often quickly realise a full return on their investment. By 'high performing' firm, we mean a business achieving in excess of \$200,000 per full time team member and EBIT before partners' salaries in excess of 50%. If you're there, by all means acquire, transform and lift your profits to new levels. If not, be prepared for yet more average performance plus even more human resources and client hassles to distract you.



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2. Acquiring or starting a financial planning division

We will begin this section by examining what has been happening in the wealth management space these past few years.

Financial planning has been a hot topic for the past decade. A minority of accounting firms have done a great job at creating wealth management divisions that serve their clients extremely well and extremely profitably. Yet as the baby boomer generation starts to retire, we stand on the verge of an extraordinary opportunity ... and many firms are not well positioned to capitalise upon it.

ING recently reported that 41% of boomers believe planning for their financial future is more difficult than the generation before them. One reason for that could be that their advisers are not doing a great job in making it easy for them.

Research predicted that in 2006, professional service firms and financial institutions in the United States alone would spend \$5.4 billion trying to understand their clients. For the most part, those firms are under-utilising technology and have no idea what those clients want or need. We would suggest they could do worse than get focused on the high net worth clients within their client base.

Take a long, critical look at yourself and your firm. What do you see? An accounting firm or a wealth manager? Ask a friend whose opinion you value to drop by your office without an appointment and ask to see someone about wealth management. See what sort of experience they have - does your office look and feel like a wealth manager's office – were they appropriately directed to the right person? Did the person in your reception area understand their question? Or did the place look more like the stereotypical accountants' office?

What do you think your clients' and prospects' perception is when they walk through your front door? Do they immediately gain confidence that the people who work in this place have high energy, appear to be organised, work to pre-defined systems and have a focus on helping ... or is it quite the opposite? (By the way, a great way to find out the answer is to hold a client advisory board with a selection of your high net worth clients and prospects).

Many accountants hope to build on the label often attributed to the profession as the last trusted adviser. Yet to offer what is known as a concierge approach to wealth management services, you will need to consider the whole range of opportunities that may present themselves. Here are some examples:

- Retirement planning
- Property investment
- Business investment
- Shares and derivatives
- Estate planning
- Succession planning
- Asset protection
- Risk management
- Loans and leases
- Venture capital

You cannot be an expert in all of the above but, as the trusted adviser, you can play a major role in project managing the delivery of the services. To do that, you need a network of advisers around you with the relevant expertise. And that is a key element driving accountants to consider starting or acquiring a financial planning business. Such a strategy must include action plans to form relationships with financial planners, bankers, lawyers and insurance brokers to build your network.

If you are serious about delivering concierge services, you will have doubtless considered the self-contained model of bringing your adviser network in-house. This can help with positioning, response times, running seminars and showing your clients that this is a major focus for you. When you move to the self-contained model, it is clear to everyone, internally and externally, that you are truly in the wealth management business.

So what are the downsides? There are three significant ones worth considering:

Firstly, consider the current economic environment. At the time of writing, the Australian stock market has fallen almost 30% from its November 2007 all time high. Depending on your paradigm, this is either a major opportunity or a major risk. One thing we know for sure is that many clients are nervous in the current environment. And when that happens, there is only one person they call to vent their frustrations – the person who put them into the investment in the first place. And when your firm is inextricably linked with your clients' financial planning, it'll be you that bears the brunt of the phone calls.

Secondly, accountants can fall into the trap of attempting to transition into financial services before they have their core business ticking over properly. The problem is exacerbated by the fact that with a service as intimate as financial planning, partners are reluctant to relinquish control of the client relationship, hence the addition of



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financial planning services only creates more work for already overburdened partners. The results – the potential for serious under-servicing of the firm’s best clients.

Tony Wood is CEO of Palm Beach, Florida-based financial solutions company, iPro One Inc. iPro One is actively engaged in acquiring ownership positions in leading US accounting firms with a view to introducing products and services designed to enable the accounting firm to monetise the full value of its existing corporate and individual relationships. Wood has consulted with over 300 accounting firms over 20 years. His assessment:

“Over the past few decades, I observed CPAs moving into the financial planning and investment advisory marketplace – with great proficiency. Their clients were receptive to them providing wealth management services, and the practice was lucrative for many firms. As CPAs navigated through the process of obtaining licenses, aligning institutional relationships and managing compliance, many reached a plateau and faced challenges that prevented them from growing their wealth management practices further.”

We see exactly the same thing happening in Australia. Notably, it is common for firms to hire dedicated financial planners and place them in their firms. Yet these eminently qualified professionals often find themselves with little work (because partners are reluctant to refer their clients to an unknown party) or, worse still, made the scapegoat for poor performance of the division.

Downside number three relates to empirical evidence that there is a clear dysfunctionality between accountants and financial planners when it comes to referral streams. Yet more evidence of the potential pitfalls can be gained by looking at the accountant / financial planner dilemma from the other side of the coin. Colin Dunn is the Principal of ReNew Group, a boutique consultancy specialising in the accounting and financial planning professions. Dunn’s company works with a major Australian financial planning dealer group, providing them with web-based solutions designed to enhance joint venture alliances between planners and accounting firms.

“Virtually every financial planning firm I come into contact with has had at least one bad experience in attempting to establish alliances or joint ventures with accountants” says Dunn. “Most JVs are entered into with the expectation that between 50 and 60 percent of the accounting firm’s clients would be ripe for referral to the financial planners. In reality, it is not uncommon to see less than 5 percent being referred. Both parties continue to see massive opportunities, yet the marriage between the relationship based accountants and the transactional based planners is often doomed from the start.”

3. Bolting on a specialist business coaching division through the acquisition of a 10x franchise

During the 1990s and early 2000s, some 3,000 firms around the world attended the Accountants’ Boot Camp run by Results Accountants’ Systems. They were drawn by a compelling marketing message urging them to change the way they worked with their clients, moving away from compliance-based services and towards assisting their clients with business development and business growth strategies.

Some firms attending these programmes were phenomenally successful, a testament to the integrity of them. Many came away inspired and ready to take on the world, but failed to implement. Weighed down by low value clients and an ever increasing compliance burden, they simply did not have the time (and in many cases, the skills) to move into this lucrative area. There are three reasons why business development did not work for the majority of firms:

1. Partners were too busy to dedicate serious time to making a business development division work in their firm
2. Partners did not have the skills to implement the growth strategies with their clients (incidentally, it is our view that this challenge is more philosophical than pragmatic, meaning that partners lack the self esteem to confidently advise clients in this area. This should not be the case, since most accounting partners deal with successful businesses every day and know exactly what works and what doesn’t work)
3. Clients had difficulty understanding the gap between where the accountant had traditionally operated compared with where they were now attempting to position themselves (questions such as “why haven’t you talked with me about this before” were met with partners running back to the sanctity of their office with their tails between their legs).

Despite these challenges, there was, and importantly, still is a real need for business advisory services. In fact, many business owners in Australia are in all likelihood about to enter a period of difficult trading conditions for the first time in their business lives. For the past five years, many business clients have only had to turn up and go through the motions to make good profits.

It’s when times are bad (or on the precipice of potentially becoming so) that business owners need your help more than ever. When the economy is strong, you can be blinded by the light and oftentimes that light can hide from view the real weaknesses that exist in so many businesses. Interestingly, the light can also blind business owners to the underlying strengths



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in their business to the extent that they simply take things for granted. When the going gets tough, both the strengths and weaknesses are revealed.

An economic downturn is a time when the business landscape has a major clearing out. It's a time in the cycle that presents business owners with an opportunity to lay the groundwork to build their profitability and net wealth by addressing the things they should have been doing right when they were 'riding the wave'. And, for already well-run businesses, it is the perfect time to gain competitive advantage by focusing even harder on the things that have made them successful.

In other words, your clients need you now more than ever.

Accounting firms too often dabble in offering a range of services to meet their clients' needs. Yet few are skilled at translating what they do into client outcomes. It is for this reason that clients simply do not understand what you do and how you can help them. Go to five random accountants' websites and you're likely to see the same thing; a page entitled Our Services, where you'll find (not surprisingly) a long list of services – the most we have seen is 38 services! The aim seems to be to have the longest list possible.



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Here are some ideas for translating what you do into a business outcome:

Your Current Service	Cited as a client outcome
Cash Flow Forecasts	A cash flow forecast is an essential management tool. We recommend that you update this money map on a regular basis and that it be used as a working document to help you attain profit targets and manage cash effectively. We can work closely with you to build a forecast tailored specifically for your business, taking into account seasonality and other issues that affect your business.
Asset Protection and Succession Planning Strategies	The development of your succession plan includes identifying the various options for the future of your business after you retire. You should evaluate each option and put in place the necessary steps to ensure you can attain your preferred approach. Even if the planned date of your retirement is some time away, the steps you take in setting up a succession plan frequently involve implementing sound business principles. With the potential to improve the performance and hence profitability of the business, why wait?
Budgets	There are two important stages in the development of budgets: firstly the preparation of the forecasted profit and loss account and secondly (and very importantly) having a system to ensure that action is taken when the actual results differ significantly from those predicted. We can meet with you on a monthly or quarterly basis to act as an independent sounding board, help you interpret any differences arising from comparing actual and forecast results and make recommendations for keeping the business on track. Two well-known maxims remind us that “what gets monitored gets managed” and that “in business we need to work smarter, not harder”. A forecast profit and loss account plan is as important for a business as preparing a flight plan is for a pilot.
Key Performance Indicators	Key performance indicators (KPIs) are financial and / or non-financial measurements that are monitored on a regular basis. The performance of a business can be evaluated by monitoring just five or six KPIs. KPIs will vary from one business to another being based on the specific areas where performance has an impact on the profit the business enjoys. The final outcome of this process is a regular KPI report, that you can use as the basis for monitoring performance to ensure that your business stays on track to reach and exceed its targets.
Business Plans	Your business is a dynamic organisation and everyone should live and breathe the vision as embodied in your strategic business plan. The plan should guide you when major decisions are required. Yet we are surprised at how few businesses invest sufficient time on these vital aspects of management. For your strategy to succeed, it is vital that everyone who needs to know about it is informed. You should ensure that everyone understands the purpose and direction of the business and what their individual and collective roles are in making it happen. Ideally, this should be linked to some form of regular monitoring to ensure those roles are being fulfilled. After all, if everyone does everything they are required to do under the plan, the business will achieve all its goals.



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Given that now is a great time to be talking with clients about business improvement, what is the most effective way to integrate such a service into your firm? One extremely effective way to do so, and a way adopted with great success by 20 leading Australian firms in the past nine months, is to bolt on a specialist business coaching division that does not impinge on your already busy schedule. That solution is to invest in the 10x opportunity.

In this report, we have looked at the typical returns earned by traditional accounting firms. We have discussed how acquiring another accounting firm has the potential to add average to average, producing yet more average. We've also examined the significant opportunities and major pitfalls involved in financial planning as an avenue to grow. So it's appropriate to look at the numbers associated with a 10x franchise.

Here's how the numbers pan out. We'll base our example on a typical small to medium sized accounting firm with 400 business clients.

Example of a 10x Franchise

No. of existing business clients	400
Conversion rate (existing clients) to coaching club	10%
No. of existing clients in coaching club	40
No. of businesses in your territory (approx)	5750
Conversion rate (non clients) to coaching club	0.5%
Upfront sales price for coaching club membership - planning day	\$7,000
Monthly membership fee per client	\$900
No. of new clients in coaching club	29
Total number of clients in coaching club	69
Coach time	
Number of clubs operating (assuming 8 members per club)	9
Upfront hours - Performance Goals Action - delivery and preparation	7
Total time - Performance Goals Action - 7 per Coaching Club Member	481
Hours per 10x Coaching Club	50
Total time 10x Coaching Club per year	430
Average hourly rate (revenue hours) - upfront planning session	\$1,000
Average hourly rate (revenue hours) - monthly membership	\$1,728
Revenue model	
Total monthly membership fees - once all signed up	\$61,875
Total upfront sales volume	\$481,250
Annual revenue from monthly membership fees	\$742,500
If all members joined in same month	\$1,223,750
Less costs ... ESTIMATES ONLY	
15.5% Royalty + 3% Marketing Fund + 1.5% Roll Out Fund	\$244,750
10x Coach + Bonuses	\$120,000
10x Admin/Marketing Coordinator	\$65,000
Start Up , Set Up Etc ...	\$50,000
Subtotal	\$479,750
Balance	\$744,000
Gross Profit	61%



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The numbers speak for themselves. To highlight the salient points:

1. Your clients need help, now more than ever before
2. We know from experience that if you try to provide that help as a 'service' of your firm, you may meet resistance because it is too far removed from what you have traditionally offered
3. We are entrenched in a seriously difficult labour market, with a reported excess of 20,000 advertised accounting jobs when compared to candidates available in Australia
4. If it is so difficult to hire accountants, doesn't it make sense to add on services that do not depend on accountants to deliver them?
5. If you could find an opportunity that could deliver over \$1M in additional revenue with a 60% margin with just two full time equivalents, neither of whom are accountants (one coach and one administrative support person) wouldn't that be worth considering?
6. Of the three options outlined in this report, which presents the best (and easiest) value proposition for you?

We hope you'll agree that the 10x opportunity is worthy of serious consideration. Please contact us for more information on how you can secure your territory and start to enjoy the returns you deserve as a trusted adviser.