You are your Customer List

by Ronald J Baker

About the Author

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Ronald J Baker started his accounting career in 1984 with KPMG Peat Marwick's Private Business Advisory Services in San Francisco. Today, he is the founder of VeraSage Institute, a think tank dedicated to teaching Value Pricing to professionals around the world.

As a frequent speaker at CPA events and conferences, and a consultant to CPA firms on implementing Total Quality Service and Value Pricing, his work takes him around the world. He has been an instructor with the California CPA Education Foundation since 1995 and has authored eight courses.

He is the author of the best-selling marketing book ever written specifically for the accounting profession, *Professional's Guide to Value Pricing*, *Fifth Edition*, published by Aspen Publishers, Inc. He has also written *Burying the Billable Hour* and *Trashing the Timesheet*, published by ACCA. His most recent book, *The Firm of the Future: A Guide for Accountants, Lawyers, and Other Professional Services*, co-authored with Paul Dunn, was published in April 2003 by John Wiley & Sons, Inc.

He graduated in 1984 from San Francisco State University with a Bachelor of Science in accounting and a minor in economics. He is a graduate of Disney University, Cato University, and the University of Chicago Graduate School of Business course: *Pricing: Strategy and Tactics*. He is a member of the Professional Pricing Society and presently resides in Petaluma, California.

To contact Ron Baker:

VeraSage Institute tel: (707) 769 0965 fax: (707) 781 3069

e-mail: BandBRJB@aol.com or Ron@verasage.com www.verasage.com

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Ronald J Baker

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Preface

It's axiomatic: You're as good – or as bad – as the character of your Client List. In a very real sense, you are your Client List!

– Tom Peters,
The Professional Service Firm 50

I am obsessed with studying success. I have learned many things from Peter Drucker, the preeminent management consultant and thinker – and someone who richly deserves a Nobel Prize – but perhaps nothing as profound and enduring as what he wrote in his autobiography *Adventures of a Bystander*:

I never heard well enough to be a musician. But I suddenly perceived that I myself would always learn by looking for performance. I suddenly realised that the right method, at least for me, was to look for the thing that worked and for the people who perform. I realised that I, at least, do not learn from mistakes. I have to learn from successes. It took me many years to realise that I had stumbled upon a method. Perhaps I did not fully understand this until, years later, I read – I believe in one of Martin Buber's early books – the saying of the wise rabbi of the first century: "The good Lord has so created Man that everyone can make every conceivable mistake on his own. Don't ever try to learn from other people's mistakes. Learn what other people do right." (Drucker, 1994: 75)

Adam Smith brought this profound insight into his seminal book *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776). He attempted to explain why some countries were wealthy, not why most countries were poor (notice the title is *not An Inquiry into the Nature and Causes of the Poverty of Nations*). Poverty needs no explanation, nor do we learn much from studying it, since it is the natural condition of humans since they emerged from the cave.

What would we do once we discovered the *root causes* of poverty? Create more of it? What needs to be explained is *wealth*, not poverty. After all, wealth is the best known antidote to poverty. What separates a good social scientist from a mediocre one is this understanding.

From this method arises another of Drucker's admonitions: "*Do not solve problems; pursue opportunities*." The difference is critical, and every firm should spend at least as much time pursuing opportunities as it does solving problems, if not more. Outsource your problems, and focus even more resources on your opportunities.

Why are accountants successful? It is a profoundly important question, especially in today's marketplace where accountants are among the ultimate knowledge workers, creating wealth for their customers from the ideas and intellectual capital they generate. Surely professionals are not successful because they sell hours, because no customer buys hours. Customers buy results, expectations, good feelings, solutions to problems, hope, dreams, a lifestyle, and a preferred vision of the future.

As I pointed out in the companion to this book, *Trashing the Timesheet*, the profession is operating under a theory of the firm that is increasingly irrelevant to the critical success factors that determine its – and its customers – destiny. We are still mindlessly mired in the notion that the way to create wealth in an accounting firm is to leverage people and hours.

However, no one entered this profession with the dream of being a galley slave on the SS Billable Hour. No, you entered the profession in order to help other people; but you soon learned that since helping your fellow human beings could not be measured very accurately – because it has to do with "soft, touchy-feely" things – it had been replaced by more hard measures of efforts and activities (such as billable hours), which bear little relationship to the results achieved for customers.

If there is one lesson I have learned from studying successful professional firms around the world, it is this: customer selection and retention is arguably the most important criterion a firm can establish for long-term success. In a world of increased competition,

customisation, and specialisation, firms can no longer be all things to all people. There is a grave danger of falling between two stools. It is critical to define your target customers; what they need, want, and expect from you; and the value proposition you will offer them. The most successful firms turn away more business than they accept because they are diligent in pre-qualifying potential customers and have made the strategic decision not to accept any and all comers.

Because this is so important, I have included a profile of a firm which used the ideas contained in this book to stratify, grade, segment, and fire its customers. I think you will agree after reading this story that fewer customers – of the right kind – equals more profits, and a better quality of life.

I hope this book helps you not only learn from success, but achieve a better quality of life for yourself, your team members, and your customers.

Petaluma, California
20 October 2003

Why Customer, Not Client?

Words mean things. The words we use and the language we adopt, as a firm and as a profession, take on certain meanings over time. They become part of our culture, the way we do things, as they say. As I began researching the Total Quality Service (TQS) and customer loyalty movements, it struck me how many organisations have tried to call their customers something other than a customer. This puzzled me until I discovered Karl Albrecht's book *The Only Thing That Matters*. Here is what Albrecht had to say with respect to the words we use:

> In an organisation, the language that people use when referring to customers, or when describing service-quality programs, signals very clearly how they view their customers and how they see themselves as relating to them. Many organisations have evolved a special terminology that enables them to *avoid* referring to people as customers.
> [Emphasis in original] (Albrecht, 1992: 9)

The word client, when you look at its etymology, is an inappropriate word to describe the relationship between a professional and the person he or she serves in today's marketplace. Client is derived from the Latin word *cliens*, which is a follower, retainer, one who follows his patron. In other words, a person dependent on another, as for protection or patronage.

Customers are people; consumers are statistics.

– Stanley Marcus (1905–2002), Quest for the Best

According to my dictionary, "among the ancient Romans a client was a citizen who placed himself under the protection of a patrician, who was called his patron; a master who had freed his slave, and retained some rights over him after his emancipation; a dependent; one under the protection or patronage of another." Are these the types of image you want to project?

THE PROBLEM WITH THE CONTEMPORARY MEANING

I realise words change in meaning, and they adopt contemporary usage and generally accepted definitions, and client is no exception. The dictionary also describes client as "a person or company for whom a lawyer, accountant, advertising agency, etc. is acting; loosely, a customer; a person served by a social agency." But visit any governmental agency that dispenses aid to individuals, and you will soon discover they too use the word client. A social worker may have clients but I do not believe this describes the relationship we have (or want) with our customers.

What has happened to the word customer, and why do so many businesses attempt to describe the people they serve as something else? After all, customer is derived from the word *custom*, which is something done regularly. Therefore, a customer is a person who buys, especially one who buys regularly.

Why is it when you go see the doctor, you're a "patient," when you board an aeroplane, a "passenger;" when you get into a taxi, a "fare;" to your utility company, a "ratepayer;" to your insurance company, a "policyholder;" and to a newsletter, a "subscriber."

What's going on here? Why not call customers what they are? Why do businesses develop a special terminology to describe what is, in essence, a commercial transaction? It is as if professionals believe we are not subject to the laws of supply and demand along with everyone else. Partially, it's arrogance, a way for us to feel superior about ourselves relative to our customers. After all, one doesn't "sell" to a client; one doesn't pander in the marketplace with non-professional advertising to attract clients; rather they seek us out for our expertise, experience, guidance, etc. Does this sound like the current environment in which we operate?

The customer is sovereign, period. We may not like it, we may wax nostalgic for the old days, when customers paid regardless of the service they received, but those days are gone, forever. Professionals can no longer place themselves above the “crass marketplace.” We must participate in it, and we must differentiate ourselves from the competition if we are to succeed.

I’m not suggesting that if you change your vernacular, you will automatically instil a culture committed to the customer. Far from it. But the words you use to describe the people you serve say an enormous amount about the attitude of your firm – and it is the attitude and actions of your people that ultimately determine your firm’s culture.

I don’t expect many professionals to adopt the word customer. And that’s a good thing, for you. After all, you’re reading this book for the purpose of differentiating yourself from the competition, because competition really is conformity. Start referring to your clients as customers, and you will discover it has a salutary effect on your attitude, firm culture, customer loyalty and respect, and, ultimately, your bottom line.

The Marketing Concept

There is only one boss: the customer. And he can fire everybody in the company, from the chairman on down, simply by spending his money somewhere else.

– Sam Walton, founder of Wal-Mart (1918–1992)

You are not in business to make a profit. Profit is merely oxygen for the body; it is not the reason for being. Profit is nothing more than a lagging indicator of what is in the hearts and minds of your customers.

Peter Drucker has indefatigably pointed out that “there is only one valid definition of business purpose: to create a customer” (Flaherty, 1999: 131). This is known as the *marketing concept*. The purpose of any organisation – from a governmental agency, non-profit foundation to a corporation – exists to create results *outside* of itself. The result of a school is an educated student, as is a cured patient for a hospital. For an accounting firm, a happy and loyal customer who returns is the ultimate result.

The only things that exist inside of a business are costs, activities, efforts, problems, mediocrity, friction, politics, and crises. There is no such thing as a *profit centre* in a business; there are only *cost* and *effort centres*. In fact, Peter Drucker wrote: “One of the biggest mistakes I have made during my career was coining the term profit centre, around 1945” (Drucker, 2002: 84). The only profit centre is a customer’s cheque that doesn’t bounce. Customers are absolutely indifferent to the internal workings of your firm in terms of costs, desired profits levels and efforts. Value is only created when you have produced something the customer voluntarily, and willingly, pays for. For example, cosmetics companies, as Revlon founder Charles Revson pointed out, sell *hope*. What makes the marketing concept so breathtakingly brilliant is the

focus is always on the outside of the organisation. It doesn't look inside and ask "What do we want and need?" but rather it looks outside to the customer and asks "What do you desire and value?"

Your firm exists to serve real flesh and blood people, not some mass of demographics known as "the market." As Stanley Marcus (the son of one of the founders of the department store Neiman-Marcus) used to love to point out, no market ever purchased anything in one of his stores, but a lot of customers came in and bought things and made him a rich man. In the final analysis, a business doesn't exist to be efficient, to do cost accounting, or to give people fancy titles and power over the lives of others. It exists to create results and wealth outside of itself. This profound lesson must not be forgotten.

What Customers Really Buy

The secret of staying afloat in business is to create something people will pay for.

– Thomas Edison (1847–1931)

Building on Peter Drucker's *marketing concept* – which states the purpose of any organisation is to create results outside of itself – you must have an understanding of what it is the customer is actually paying you for.

WHAT DO CUSTOMERS REALLY BUY?

One of the problems accountants have in truly understanding their customers is they tend to focus on the technical aspect of what they *do* for the customer, rather than on how the customer *benefits* by what is done on their behalf. Business people are constantly being exhorted to *listen* to their customers, but perhaps a better strategy is to *become* a customer. This is not as difficult as it sounds, as all of us are customers every single day and we understand why we buy things, what we look for in choosing a service provider and how we feel about the overall experience with the organisation. While many accountants don't necessarily have experience in purchasing accounting services for themselves, some do (eg, financial directors in industry have to hire accounting firms). It is quite a learning experience to talk to these professionals about how and why they make the decisions they do, since they are sophisticated buyers who now sit on the other side of the desk.

It is a deceptively simple question: what are we getting paid for? Yet many accountants arrogantly assume they know what their customers want, thinking they have been giving them exactly that for years. Yet this is a myopic vision and potentially harmful. We have a plethora of information on why people buy,

how they buy, the decision process they go through, which firms ignore at their peril.

In his book, *How to Win Customers and Keep Them for Life: Revised and Updated for the Digital Age*, Michael LeBoeuf, Ph.D, suggests customers have the following motivations for these various purchases:

- Don't sell me clothes. Sell me a sharp appearance style, and attractiveness.
- Don't sell me insurance. Sell me peace of mind and a great future for my family and me.
- Don't sell me a house. Sell me comfort, contentment, a good investment, and pride of ownership.
- Don't sell me books. Sell me pleasant hours and the profits of knowledge.
- Don't sell me *things*. Sell me ideals, feelings, self-respect, home life, and happiness. (LeBoeuf, 2000: 22–23)

Try this exercise

Complete the following phrase:

- Don't sell me accounting services, sell me ....

Notice how these sayings not only apply to the physical product, or service, but also to the feelings and experiences that go along with them. This is an essential part of a firm's value proposition, which we will discuss in the next chapter.

Again, Michael LeBoeuf distilled his summation of customer statements and posited the following theory to explain what people really buy:

Despite all of the untold millions of products and services for sale in today's marketplace, customers will exchange their hard-earned money for only two things:

- Good feelings
- Solutions to problems.

(Ibid: 23)

This is a good theory and it has a certain utilitarian streak to it – that is, the notion individuals spend their time (and money) pursuing pleasure and avoiding pain. It is the old marketing axiom that says you really don't buy drill bits, you buy the hole the drill makes. Understanding that simple fact could help a company (such as Black &

Decker, for instance) get into the laser beam business, since they too put holes in things. It also explains why so many people purchase lottery tickets; they are really buying a low cost dream.

Accountants are excellent at solving customer problems; it is, after all, what they are trained to do. But merely solving problems is no longer enough, we must also provide the good feelings that are a part of the customer's experience in dealing with our firms.

The point is also that the process of solving the problems is just as important to the customer as the results achieved. Focusing on the total customer experience – solving the problem and creating the good feelings – demonstrates not just *competency*, but *distinction*. But the utilitarian view posited by LeBoeuf does not help a firm customise its service offering to its various customers. It is easy to get caught up in hairy hypotheses that are long and complicated, but I prefer to shave with *Occam's razor* – a medieval philosophical concept that states it serves no purpose to achieve a result with many assumptions rather than with a few.

I prefer Theodore Levitt's theory of what customers really buy: *expectations*. Levitt was a marketing professor at Harvard Business School, and once the editor of *Harvard Business Review*. His "expectations" theory is useful because it forces the firm to focus on the utility the customer is trying to maximise. No two customers have the same expectations and therefore each one has to be treated differently.

Levitt's theory also emphasises the importance of ascertaining the customer's expectations *before* accepting them as a customer, or doing work for an existing customer. Since the customer judges a firm's performance as a function of how they perceive the firm's performance divided by what they expected, it is a critical step in the service delivery process to understand exactly what those expectations the firm will be graded on are. Before each engagement the firm must (yes, *must*) ask the customer: "What do you expect from us?"

Asking this question allows the firm to manage – to a certain degree – the customer's expectations. If a customer has unrealistic expectations, better for the firm

to find out *before* it begins any work, rather than *after* it has committed firm resources to an unreasonable customer.

An accountant met for the first time – after being warmly referred by another customer – with a CEO of a company who needed a full disclosure financial statement compilation. During the meeting, the accountant asked the CEO, "If you decide to hire us, what do you expect from us?" The CEO was a little taken aback by this question – probably because no other accountant had ever asked him that before – and began to explain how what he really wanted was for the accountant to develop a relationship with his banker. It seems his company had a rather cyclical cash flow cycle and during certain periods of the year his company would be in violation of the banker's loan covenants. He told the accountant: "If my banker is comfortable with my accountant, I'll be able to sleep at night." This was the *customer's expectation* and the accountant focused on this aspect of the relationship immediately. Because he was able to exceed the customer's overall expectations by developing an excellent relationship with the banker, he was also able to command a premium price for the financial statement compilation. If all a firm ever focuses on is the technical aspect of the job – in this case, the compilation – and never looks for the *value drivers* that reveal the deeper understanding of exactly what the customer is buying, it is destined to be treated like a commodity, with no viable difference between itself and the competition.

Because expectations are *dynamic*, not *static*, it is also imperative the firm continuously asks the customer what they expect, at least annually, if not in shorter intervals – after every engagement, for instance. A firm should never rest on its laurels and assume it knows exactly what the customer needs.

Today, your firm competes against *any* organisation that has the ability to raise customer expectations. Once people experience premium service, they want more of it and are less and less tolerant of those organisations that do not deliver on the promise. This "expectation dynamism," though, requires that firm leaders constantly look beyond their own four walls to learn from other industries. Unfortunately, under the old way things were done, as people rise within a firm their focus becomes

more and more internal, dealing with problems and crises within, rather than opportunities and possibilities outside.

Continuous learning from customers is an ongoing process and requires many different listening posts to accomplish. It is not enough to send out an annual "how are we doing?" customer satisfaction survey. Most people do not fill these out, limiting their response and usefulness right from the start. Further, most of the questions are biased and may not deal with the issues the customer is concerned about. Not many customers are very excited to fill these out, as they tend not to spend their waking hours cogitating on how their professional service providers can do better. Disney is a company that has mastered surveying and listening to their customers. At the Disney University course on customer loyalty they teach the most significant factor that determines whether or not a family will return to a particular resort hotel comes down to one item (and this Disney executives were shocked to learn, according to the instructors): the swimming pool. They now invest heavily in each new resort's pool. No doubt in a few years' time, this expectation, too, shall change.

Do you know what *your* customers most value about you?

Focusing on the customer's individual expectations forces the firm to individualise its service delivery to that particular customer's wants and needs. No two customers should be treated equally. Customers want to be treated *individually*, or better yet *specially*. This is inherently easier to accomplish in service organisations than in manufacturing, although with the recent trend towards "mass customisation" of everything from Levi Jeans and baby dolls, to bicycles and children's books, this is changing.

Listening to your customers – and team members – is a crucial tool and will help you solve that perennial issue all firms desire, that of *cross-selling* your services.

WHY HAS CROSS-SELLING NOT BEEN AS SUCCESSFUL AS IT COULD BE?

It is the mantra in almost every accounting firm to cross-sell, yet most firm leaders are disappointed with the results of these efforts. This is directly linked to figuring

out each customer's expectations. Perhaps one of the reasons most firms are not satisfied with their cross-selling results lies in the belief that all we have to do in order to sell more services is to be the customer's "trusted advisor." But there is a more fundamental customer psychology and it is directly related to the words we use. People love to *buy* and *own*, but they hate to be *sold*. Think of the last time you purchased a big ticket item – a car, stereo, new computer, house, etc – did you get on the phone with a loved one, friend, or colleague and say, "Guess what I was sold today?" Rather than focusing on what firms want to sell their customers, perhaps they should start focusing on what the customers' desires and wants are.

After all, in almost every seminar conducted to professionals around the world, I ask this simple question: "When was the last time you visited with a customer, unannounced, and asked the owner, 'So, how's it going?' And when you did that, six out of ten times (maybe more) what did you walk away with?" Almost everyone nods and says, collectively, "More work." Woody Allen once said 90 per cent of success is showing up.

Yet most professionals are so focused on billing hours and since visits of this nature distract from that fundamental mission, they lose out on all sorts of cross-selling opportunities. Furthermore, the compensation structure of most firms tends not to reward cross-selling behaviour (and investments) and we tend not to witness what does not get rewarded. And, of course, those lost opportunities do not show up in any of the conventional firm measurements or metrics of team member performance.

Rather than cross-selling, I prefer the term *cross-buying*, given that people do not like to be sold. In order for a customer to want to *buy* more from your firm, they first have to understand the full menu of your service offering. Yet, based on experience, I have heard many firm customers say, "I didn't know they offered that service." Whose fault is that? The firm's, of course. It is as if you ran a restaurant and were reluctant to pass out a menu listing all of your courses, or did not offer a dessert menu and wine list (the most profitable items).

It is even worse than it seems. Many firms, for example, see *consulting* or *professional services* expense on their customers' income statements and when they ask the customers what it was for, the reply is usually, "We hired so and so to do such and such." Of course, the accountants say, "We could have done that," and the customer replies, "I had no idea." But if you are constantly striving for a deeper understanding of your customer's expectations, wants and desires, you will be in a position to capture these additional services when they arise.

Now that we have discussed what people buy, let us turn our attention to the firm's value proposition and how it plays an important strategic role in devising and delivering results to the firm's customers.

The Value Proposition

In the 1980s BA stood for Bloody Awful amongst flyers, and had always been subsidised in spite of its poor service and resulting losses. Margaret Thatcher ended that when she privatised the flagship carrier in 1987. Now, suddenly British Airways had to compete and it started by rethinking its fundamental value proposition. It innovated the concept of Club World business-class service, which provided the business traveller – the most profitable segment in the airline industry – with a truly unique flying experience. BA's major insight was to focus on the totality of the traveller's experience, from how he or she experienced the airline from travel origination to destination. By focusing on the value proposition it was offering its customers, BA became the world's most profitable airline by the late 1980s.

More and more, companies have realised it is not enough to focus on simply the value of the product or service being offered; they have to take into consideration the total ownership experience from the customer's vantage point. They have to provide a value proposition, in totality, when compared with the customer's viable alternatives and offer a better deal. The originator of the value proposition, Michael J Lanning (a former Proctor & Gamble executive and consultant with McKinsey), defines it this way in his book *Delivering Profitable Value: A Revolutionary Framework to Accelerate Growth, Generate Wealth, and Rediscover the Heart of Business*:

It's not enough to satisfy the customer. Not nearly enough. You've got to move beyond customer satisfaction to customer delight.

– Dr W Edwards Deming (1900–1993)

Essentially, a value proposition is the *entire set of resulting experiences*, including some price that an organisation causes some customers to have. Customers may perceive this combination of experiences to be in net superior, equal, or inferior to alternatives. A value proposition, even if superior, can be a 'Tradeoff,' ie one or more experiences in it are inferior while others are superior.
(Lanning, 1998: 55)

When most firms think about their value proposition, they usually include the following elements:

- Trusted advisors
- A long-term history
- In the profession for the long-term
- Good reputation and/or brand name
- Technical expertise
- Knowledgeable and experienced professionals
- Utilises latest technology
- Committed to our customers

The problem is, none of the above characteristics describe the *experience* the customer will have with the firm. No doubt, many of the above are expected by customers, but they are not related to customer experiences. It is very difficult to catalogue all of the various experiences a customer will have with a professional service firm. In fact, this is an exercise the firm needs to conduct in order to enhance the value of the total experience for its customers. However, some generalisations can be made. The experiences a customer will have in interacting with a firm generally revolve around three areas:

- Quality
- Price
- Service

A firm must look at the interaction of all three of these variables and decide which combination of each it will deliver to its customers. Focusing on any one is not enough, since the three are interdependent and not mutually exclusive.

Mercedes-Benz (now Daimler-Chrysler) always touted its high quality to the marketplace, since they essentially started the automobile industry and had built up a reputation for excellence in engineering. But in the early

1990s Lexus came along and offered customers a superior value proposition, not just in terms of price (indeed, a Lexus is not materially cheaper than a Mercedes), but rather in the totality of the ownership experience. Between 1985 and 1992 Mercedes' market share dropped from 11.6 per cent to 6.4 per cent, with the total units sold in the United States going from approximately 100,000 in 1986 to 59,000 in 1991. Resting on your laurels in terms of technical quality alone is a prescription for losing customers. The Japanese even have a term for this: *atarimae hinshitsu*, which means *quality taken for granted*.

No accounting firm can compete on quality alone; it is merely *a table stake* – that is, the minimum you need to play the game. Who is going to stay with an incompetent accountant? Besides, customers cannot easily judge the technical expertise of the professionals they use, any more than you can be confident in the technical competence of your doctor. What customers do know is how they are treated – the bedside manner of the doctor – and, based on the empirical evidence, this treatment determines whether or not the customer remains loyal.

Price is also not enough to attract customers; if it was, books.com should have been a raging success, since it sold books cheaper than amazon (it is now gone, disappearing even before the dotbomb of 2001). Think of Ryanair. By their own definition, they are the low fare leader in the airline industry, but would that be enough to retain customers if they did not provide good quality flights and value for money? If everyone was price conscious, we would all be driving Hyundais. Customers are not *price* sensitive; they are *value* conscious.

Some firms tend to think about their value propositions in terms of a SWOT analysis – Strengths; Weaknesses; Opportunities; and Threats. A SWOT analysis is indeed a useful concept for firms to work through, but it does not deal with customer experiences explicitly. The same can be said for benchmarking best practices. Unless you can relate these tools to what the customer actually experiences in dealing with your firm, they are half measures at best. Remember, customers do not experience a *strategy*, they experience the *execution* of the strategy.

Focusing on the value proposition – and the resulting experience the customer will have – forces the firm to utilise those items that provide the most latitude in creating an overall positive set of experiences for the customer. Since there is not much latitude in working with technical quality, that leaves price and service. The former provides an enormous opportunity to provide a competitive differentiation to your firm's customers by adopting innovative and creative pricing strategies. By customising your services into Fixed Price Agreements and utilising Change Orders, your firm will be able to remove fear, uncertainty, doubt and risk from your customers. This is an enormous competitive advantage and one that is explored more in the companion booklet *Burying the Billable Hour*.

The latter characteristic– service – is only limited by your firm's imagination. It is excellent service that separates the best firms from mediocre firms. Companies with an excellent service record are, for the most part, price *makers*, not price *takers*, in their respective industry. Think of Disney, FedEx, Harrods, Lexus, Ritz-Carlton, Sony, and American Express – all of these companies charge a premium, they do not let their competition dictate their price and they consistently offer a superior service experience to their customers. Another reason service excellence is such a critical component of your firm's value proposition is because your competitors can match technical quality and price fairly easily. If they do not have the expertise in house, they can go buy it (or rent it); and there is *always* some firm, somewhere, willing to do what you do for a lesser price.

While competitors may be able to match (or beat) your price, what cannot be very easily matched – or even observed, for that matter – is your firm's service quality, the bedside manner your professionals have with your customers. Moreover, as will be explored later, most professionals lose customers not over price or quality issues, but rather over service related issues. Overall, then, service excellence is an enormous fulcrum to develop your firm's value proposition and create superior experiences for your customers.

IS BEING A TRUSTED ADVISOR ENOUGH?

In the aftermath of Enron and other assorted accounting scandals of 2001 and 2002, there has been a lot of discussion about the *trust* factor in the accounting profession. Phrases such as *trusted advisor* have become common in firm's mission and value statements. In fact, many believe trust is a *core competency* of the profession. I have a different perspective on this issue, which I have learned is very controversial since when sharing it with many colleagues it ignites quite a debate.

In any economy, a high level of trust acts as a lubricant to commerce, reducing the need for lengthy negotiations, protracted contracts and costly litigation, or what economists refer to as *transaction costs*. Nobel Prize-winning economist Kenneth Arrow explains the function of trust:

> Now trust has a very important pragmatic value, if nothing else. It is extremely efficient; it saves a lot of trouble to have a fair degree of reliance on other people's word. Unfortunately this is not a commodity that can be bought very easily. If you have to buy it, you already have some doubts about what you've bought. Trust and similar values, loyalty or truth-telling, are examples of what the economist would call "externalities." They are goods, they are commodities; they have real, practical, economic value; they increase the efficiency of the system, enable you to produce more goods or more of whatever values you hold in high esteem. But they are not commodities for which trade on the open market is technically possible or even meaningful. (Quoted in Fukuyama, 1995: 151–52)

You can't purchase trust, it is a *table stake* in a free market economy and not just for accountants, but for *all* businesses. All transactions require trust, it is a basic expectation when conducting business. It certainly *is not* a core competency, because it is not an attribute you can do better – or at less cost – than your competitor. It is a mistake for any firm to advertise or market its trustworthiness; it is frankly something that must be demonstrated and earned (one way to accomplish this is to offer a money-back guarantee on all of your work, with the possible exception of audits). Merely having trusting relationships with your customers does not ensure they will remain loyal.

I fly quite extensively on United Airlines; I trust them with my *life*, which certainly requires a higher degree of certainty and confidence in a complete group of strangers than in selecting my accountant or lawyer. In the airlines, safety is simply a *table stake* – it is necessary, since it is hard to sell anything to a corpse, but it doesn't ensure customer loyalty, or even profitability. If United's service ever begins to decline, I will defect and we witness the same response among customers of professional service providers. The majority of transactions that take place in the world-wide economy are done under an umbrella of trust. Professionals are among the most trusted advisors. So what? This is a subtle point, but an important one. The profession – or any firm therein – does itself no favours by continuously trumpeting its level of trust. Like your technical quality, it is merely a *table stake*. Those who talk about it, injure it, and are perceived as less believable.

Certainly you can lose customers if they lose faith or trust in you – and you will be the last to know – but that is not the reason the majority of customers defect from their accountant. As we shall learn, most defections occur over the service experience, not issues of integrity and trust.

From Zero Defects to Zero Defections

I recall obtaining a new customer while in practice, the owner of a successful travel agency. Her husband had passed away the prior year and she had never had to deal with the tax and accounting aspects of her business. Her husband had been using the same accountant for over twenty years and when I asked (as I made a habit of doing) why she left her accountant, her answer was very laconic and poignant and one I will *always* remember: "He showed no compassion."

From what I could determine, the accountant's work was technically proficient. She had no complaints about his price or the quality of his work (in fact, my price was four times his). She even trusted him. When I called him to ask for copies of certain documents, he was shocked that he had been replaced. It wasn't the *technical quality*, but the *service quality*, that made all the difference to her. Not *what* she got, but *how* she got it.

During the 1980s Total Quality Management swept the business literature and many companies rushed to institute a TQM programme. But TQM focuses internally on processes and procedures, not externally on results and value. As Peter Drucker says: "Nothing is so useless as doing efficiently that which should not be done at all." We need to shift our thinking from everything begins and ends with management to everything begins and ends with customer value. Counting and measuring things for the sake of counting and measuring things will not be the *open sesame* to attracting and retaining customers. The alternative to TQM is Total Quality Service (TQS), which Albrecht defines as:

If we aren't customer-driven, our cars won't be either.

– Donald E Peterson, former chairman, Ford Motor Company

"A state of affairs in which an organisation delivers superior value to its stakeholders: its customers, its owners, and its employees"
(Albrecht, 1992: 72).

Notice how this definition is a goal condition to be sought after, not a particular method of operation. Methods are developed as a way to achieve the goal, not as ends in themselves. The reason TQS is a better beacon than TQM for accounting firms is it recognises the subjective value of what is delivered, not the objective quality. Customers expect their financial statements and tax returns to be correct; TQS puts the focus and emphasis on the subjective value and the service quality, the ultimate arbiters of whether the customer remains a customer.

In the 1990s, along the line of reasoning that being customer-driven was the ultimate goal of a company, many organisations began to calculate the lifetime value of an average customer. Consultants began asking their customers, "How much are you willing to spend to acquire a new customer?" Once this amount was determined, they would respond: "Then you had better be willing to spend *at least* that much to retain one." It was the dawn of the customer-loyalty economics movement, given voice by Frederick F. Reichheld and his book *The Loyalty Effect*, among others.

In the United States the automobile industry computed a brand-loyal customer was worth at least $140,000 over the course of a lifetime, while banking found $156 per year in profit, and appliance manufactures figured $2,800 profit per customer over a 20-year period. Even the local supermarket calculated $4,400 per year and $22,000 over a 5-year period of residence in a neighborhood. The theory was businesses should look at the value of the relationship over the long term, rather than simply the maths of the moment. You are more likely to handle a customer complaint differently, or resolve a dispute in favour of the customer, if you take into account their lifetime value.

This lifetime value paradigm also proved, empirically, that customer *retention* was more profitable than customer *acquisition*. Various studies showed that it cost between four and twenty times more (depending on the industry)

to acquire a customer than it did to retain one. The American Institute of CPAs found it cost the average CPA firm *eleven* times more to acquire than retain a single customer. As a result, cross-selling became the mantra in most accounting firms, with the focus shifting from market share to *wallet share*. In other words, the question was, “What percentage of the customer’s audit, tax and consulting budget went to the firm?” For many firms, the goal was to get the number as close to 100 percent as possible. Also, many firms began to invest resources into discovering the needs and wants of their existing customers in order to sell more services to them, rather than searching the streets looking for new ones.

The loyalty movement created another positive effect, at least in terms of replacing the TQM paradigm – it focused companies away from zero *defects*, towards zero *defections*. For accounting firms, especially, this change makes eminent sense, since they would never be able to achieve zero defects anyway – to err is human, after all. And even if they did achieve this magical standard, customers would still defect over service quality. Like trust, technical quality is a table stake, the basic expectation of the customer. You do not return to a hotel because they change the linens and vacuum every day.

While the lifetime value of a customer is important, there is a better measurement for your firm to be cognisant of and attempt to compute – the lifetime value of the *firm* to the customer. This puts the emphasis not on selling more *core* services, but on increasing the amount of spending each customer does with the firm overall. Market share is simply the wrong measurement of success. What matters is to maximise the customer’s spending by ensuring their *longevity* (over a lifetime), *depth* (capturing a greater share of the customer’s wallet), *breadth* (obtaining revenues from complementary sources) and *diversity* of spending (striving for new service offerings in order to generate wealth for the customer).

This approach requires the firm to strive for customer loyalty – or what I am calling *zero defections* – of the type of customers it wants. There is an undercurrent of opinion that believes customers cannot be loyal to an organisation, other than perhaps cottage-type businesses, such as hairdressers, stockbrokers, travel agents, or local

restaurants. "How can a person be loyal to an airline or a hotel chain?" asks Karl Albrecht, who suggests customers merely have strong *preferences*, not loyalty. I disagree. If you study human behaviour, people are loyal to their spouses, schools, neighbourhoods, communities, not-for-profits where they donate money and services, and so forth. It is not so much that loyalty is dead in the business world, it is a *reason* to be loyal that is rare. Firms have to earn the loyalty of their customers and that goes far beyond just being a trusted advisor and providing technically competent work. It requires providing service experiences that exceed customers' expectations as well as personal transformations to guide them in achieving their dreams. How does a firm increase the loyalty of its customers? Let us consider this question by analysing why accountants lose customers.

WHY DO WE LOSE CUSTOMERS?

Many companies learned the hard way they could score high on satisfaction surveys and customers were still defecting. That is because satisfaction measures the *past*, while loyalty attempts to measure the *future*. Many firms have attempted customer satisfaction surveys with mixed results. There is no doubt you can learn some valuable things from them, but they are also fraught with dangers – low response rates, not addressing relevant issues, biased questions and so forth. When conducting exit interviews, firms face the same challenges. Most customers are reluctant to give the firm the real reason why they left, so they tend to respond by saying, "You were too expensive." Thankfully, many independent organisations and researchers have studied this issue extensively, and it is worth discussing some of their findings.

In their award-winning article, "How to Lose Clients Without Really Trying," published in the *Journal of Accountancy*, August J Aquila and Allan D Koltin surveyed thousands of customers who had defected from their accounting firm. Here are the top seven reasons why they left:

1. **"My accountant just doesn't treat me right."** [Two-thirds of the responses]
2. They ignore clients.
3. They fail to cooperate.
4. They let partner contact lapse.

5. They do not keep clients informed.
6. They assume clients are technicians.
7. They use clients as a training ground [for new team members].

(Aquila and Koltin, 1992: 67–70)

If we were turn the coin over and analyse what characteristics customers use to select an accountant, we would find these:

- Interpersonal skills.
- Aggressiveness.
- Interest in the customer.
- Ability to explain procedures in terms the customer can understand.
- Willingness to give advice.
- Perceived honesty.

(Winston, 1995: 170)

Notice how *price* and *quality* are conspicuously absent from these surveys. The reasons cited in these studies have not changed much since they began, some time around the 1950s. The fact of the matter is most defections from professional service firms are the result of human failings and perceptions of indifference, rather than price or technical quality. In other words, it is how people are treated – or mistreated – that determines their willingness to remain loyal. This has important implications for your firm's value proposition, and it should be apparent you want to compete based upon service, not price or quality.

Your firm's best customers are your competitors' best potential customers and you should always act as if they are at risk. By providing Total Quality Service, a value proposition that differentiates you from the competition, Fixed Price Agreements wherein you bundle services and a 100 percent money-back guarantee, you can begin to lock the customer in *golden handcuffs* – increasing their switching costs – making it difficult for any other firm to offer more value. Customers will continue to patronise those business that give them a reason to be loyal and your firm will get the behaviour it rewards. Customer loyalty is worth rewarding. As the above surveys make clear, professional services are built on relationships, where customers hire *people*, not so much firms.

In order to ensure zero defections, every firm must deal with problems when they arise. One of the characteristics

that separates excellent service organisations from mediocre ones is how they handle, and even encourage, customer complaints, a topic we explore next.

CUSTOMER COMPLAINTS

A customer complaint is a problem and an opportunity, and the opportunity is actually greater than the problem if it is handled correctly. Since it is virtually impossible for a professional service firm to avoid a complaint at some point, handling complaints when they arise provides a competitive differentiation for your firm and enhances customer loyalty and goodwill if the complaints are handled properly. Further, complaints that are handled quickly result in higher loyalty and for that reason alone one of the highest-value activities a firm can have in its repertoire of Total Quality Service policies is a proper complaint recovery system.

What is astonishing is customers who complain can become more loyal than if they had no problem at all, if the complaint is handled quickly and resolved to their satisfaction. The premium hotel chain Marriott found the following percentages of intent to return when customers had a problem during their stay:

- No problems during the stay = 89 percent return rate
- Had a problem during the stay and it *was not* corrected to customer's satisfaction = 69 percent return rate
- Had a problem during the stay and it *was* corrected to customer's satisfaction, *before they left the property* = 94 percent return rate

This is why it is so important to resolve all customer complaints quickly, or at least take action to resolve them immediately. Complaints are not like fine wines, they do not age well. A customer complains because there is a gap between what they wanted to have happen and what actually happened. Once they experience a problem, their expectation of having it resolved quickly is actually low (which is precisely why most customers do not complain – they think it will do no good), so it is an excellent opportunity to improve their condition and turn the experience from a moment of misery into a moment of magic. You will place their focus on the *satisfying outcome*, rather than the original problem.

When analysing customer complaints and firm defects, ask “How” not “Why” questions. “Why” questions tend to generate excuses and justifications, while “How”

questions will lead to knowledge to correct the problem. "How can we prevent this from happening again?" is a much better question than "Why did this happen?" Also, here is a five-step recovery process to deal effectively with all customer complaints:

1. **Apologise** – Say *I* am sorry, not *we* are sorry.
2. **Urgent Effort** – Fred Smith, founder of FedEx, had the Sunset Rule: "The Sun will not set on an unresolved customer or employee problem that is not dealt with in some way."
3. **Empathy** – Show understanding and compassion; fix the customer before fixing the problem.
4. **Compensation** – Be generous, show remorse; better yet, ask the customer how they would like it to be fixed (usually, their request is less than you would have given up).
5. **Follow-Up** – Learn how the customer feels about the situation; provides closure.

Customer complaints can be more valuable than customer compliments because they provide the firm with information on aspects of their service delivery that need to be improved, a second chance to gain the customer's business and an opportunity to actually increase the customer's goodwill and loyalty. Given these facts, firms should actually provide an incentive for customers to complain and one of the most effective strategies to do that is the 100 Per Cent Money Back Guarantee.

THE 100 PER CENT MONEY BACK GUARANTEE

Many accountants think it counterintuitive to provide incentives for their customers to complain, worrying that they would be inundated with angry customers, or if they didn't respond effectively, they might lose the customer. These fears are unwarranted, however. Supplementing the research discussed above, Theodore Levitt made this observation with respect to asking for customer complaints:

> One of the surest signs of a bad or declining relationship with a customer is the absence of complaints. Nobody is ever that satisfied, especially not over an extended period of time. The customer is either not being candid or not being contacted.
> (Quoted in Albrecht and Zemke, 2002: 86)

Obviously, this is a risky situation, so I suggest you include where allowed by ACCA rules the following Service Guarantee in all of your Fixed Price Agreements and Engagement Letters (see *Burying the Billable Hour* for more information on Fixed Price Agreements):

> Our work is guaranteed to the complete delight of the customer. If [customer name] is not completely delighted with the service performed by [firm name], we will, at the option of [customer name], either refund the price, or accept a portion of said price that reflects [customer's name] level of delight. We will assume you are delighted upon final payment received under the terms of this Agreement.
> (Baker, 2004: 145)

The advantages of this policy are many. It demonstrates to the customer that your firm is serious about Total Quality Service and providing a valuable experience for them. It puts your money where your mouth is. It is one thing for a firm to *tell* a customer how good they are, quite another to *show* them with a service guarantee. It provides your entire firm with the impetus to exceed the customer's expectations, since now your money is on the line. This focuses the firm on the only true profit centre it has – a customer's cheque that does not bounce. The service guarantee provides a competitive differentiation and helps in swaying the marginal customer to select your firm (especially in Tender/Request for Proposal work). Because having a guarantee requires a higher level of trust, the firm will do a more diligent job in pre-qualifying all of its new customers and will document the expectations of each party much more thoroughly. A service with a guarantee is more valuable in the marketplace than a service without a guarantee – because it dramatically decreases the customer's risk – and this alone enables the firm to command a premium price over its competition. It also provides word-of-mouth advertising for the firm, as customers appreciate this policy and will be less reluctant to refer new customers. It provides the customer with an incentive to complain, which, as we have learned, is more valuable than the alternative.

With all of that being said, there is an even more substantial reason you should offer a service guarantee to *all* of your customers: *You already do*. If any one of your

customers were to complain loudly enough, you would either write-down or write-off their invoice, according to their wishes. Or, you would ask them to pay only what they think is fair. Unfortunately, this is done *after* the fact, when you will receive no benefit from it. In effect, you have a *covert* service guarantee; I suggest you make it *overt* in order to obtain a marketing and competitive advantage over your competition. Again, the idea is to have an overt extraordinary guarantee policy – one that you trumpet in the marketplace.

Please do not misconstrue anything said here as meaning that "The customer is always right." That is patent nonsense. While the customer is not always right, it is no use to argue with them, since I've rarely seen anyone win an argument with a customer. The fact is, they are entitled to their feelings and will act upon them, even if intellectually they are wrong. Sometimes the only course of action is to fire them.

There is nothing worse for you firm's morale than to continue to serve customers who do not understand or appreciate the value you provide. Given a choice between continuing a relationship with a toxic customer and the effect it might have on the morale of your team members, see who former CEO of Southwest Airlines, Herb Kelleher, sided with, as this story from *Nuts!* humorously illustrates:

> … a woman who frequently flew on Southwest, but was disappointed with every aspect of the company's operation. In fact, she became known as the "Pen Pal" because after every flight she wrote in with a complaint. It was quickly becoming a volume until they bumped it up to Herb's [Kelleher] desk, with a note: "This one's yours." In sixty seconds, Kelleher wrote back and said, "Dear Mrs Crabapple, We will miss you. Love, Herb."
> (Freiberg and Freiberg, 1996: 269–70)

And this is a company which computes that, for the year 1994, only five customers per flight accounted for its entire profit (Ibid: 121). So why would Kelleher so nonchalantly fire a customer? *Because he stands up for his people and puts them first*. Once his response was published in the Southwest newsletter, what do you think happened to team member morale? If it comes down to

a choice between your team members and an unreasonable customer, side with the team members, even at the expense of short-term profits. The team members will make up for the lost revenue, but you can hardly ever recapture the loss of dignity and respect team members suffer by forcing them to work with rude and unreasonable customers. Even better, let your team members decide which customers to fire – you will be surprised how diligently they perform this task and then how motivated they are to make up the lost revenue.

Of course, one of the best ways to implement a policy of *zero defections* is to select the right customers in the first place, which brings us next to Baker's Law.

Baker's Law: Bad Customers Drive Out Good Customers

It is common in professional service firms to grade customers and focus attention on the *A* and *B* customers and even hold out incentives to the *C* customers to upgrade to *A* or *B* status. I would like to offer two distinct methods of applying this customer segmentation strategy in a more sophisticated, and rigorous, manner. Along with your human capital selection, your customer selection and retention criteria are the most important aspect of crafting your firm's success.

The traditional customer grading criteria are most likely familiar to you and usually include:

- Amount of annual revenue
- Prompt payment history
- Potential for growth
- Potential for future referrals
- Actual referrals
- Profitability of customers
- Risk of having customer in portfolio
- Timing of work (fiscal or calendar year)
- Reasonable expectations
- Willing to take advice
- Profitable and not undercapitalised

You don't have to like every client – indeed, that's the whole point, since you can't. Hence the need arises to decide on whom you do like, and to structure a plan to get more of their work, and the work of clients similar to them.

– David Maister,
True Professionalism

These are certainly important criteria and should be made part of any firm's pre-qualifying process. Ric Payne, Chairman and CEO of Principa, advocates the following twelve-point criteria in order to select customers:

- In business for at least three years
- Pleasant, outgoing personality
- Willing to listen to advice
- Positive disposition
- Technically competent
- Business is profitable
- Business is not chronically undercapitalised
- Business is not dominated by a small number of customers or suppliers
- Clearly established demand for the product or service
- Business has scope for product or service differentiation through innovative marketing
- Business has scope for improved productivity through innovative management planning and control
- Business has a strategic plan

These are all good criteria to judge potential new customers and certainly David Maister's personality criterion – that is, do we like this customer? – needs to be foremost on the list as well (from his book *True Professionalism*). There is no point in working for and with people whom you do not like, or are indifferent about.

As good as these criteria are, I want to add another important one to the list. I have come to believe that *character* is more important than personality in judging new customers. The ancient Greek philosophers held the view that "Character is destiny," and being an inveterate student of human behaviour, I find this reasoning compelling.

The Greeks spoke of *good habits* and *bad habits*. The good habits they called *virtues*, the bad habits *vices*. A person's character does provide a basis on which to predict behaviour, which is why we say certain behaviour is *in* character or *out* of it. In light of the accounting scandals in 2001 and 2002, the firm's reputation and the partner's peace of mind should be more important than profitability.

When an accounting firm accepts a new customer, it is not merely *closing* a sale. On the contrary, it is beginning

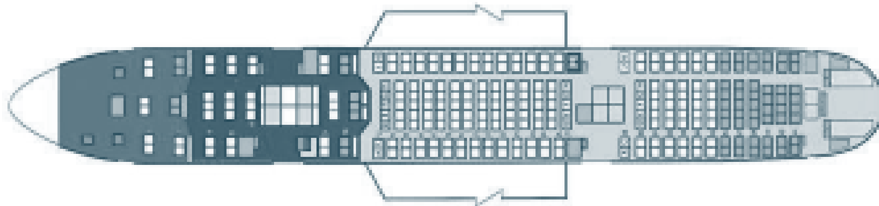
a lifelong relationship. We select our spouses, friends and other important relationships very carefully; why would we not perform a proper amount of due diligence before selecting a customer? If the customer is worth having, it is worth investing some time and resources in determining if they are a good fit for your firm.

It is no longer wise to accept any new customer simply because they have a chequebook and are alive. Let me reiterate, the most successful firms in the world all have very rigorous pre-qualifying standards and they do not accept all comers (in fact, they report they turn away more business than they accept). This is not out of arrogance, but from the recognition the firm cannot be all things to all people. Saying "no" to a new customer is not necessarily easy, but it is vital if you want to only accept customers who are pleasant to work with, have interesting work and enhance your firm's intellectual capital. Complexity kills a business and by accepting any customer – especially those that don't fit your value proposition – you are adding a layer of activity that will starve your best customers and put them at risk of going elsewhere. The Pareto Principle is always in effect – that is, 20 per cent of your customers generate 80 per cent of your profits, or even 5 per cent generate 50 per cent. In order to adopt the Pareto Principle, let me offer the following metaphor.

THE ADAPTIVE CAPACITY MODEL

Think of your firm as a Boeing 777 aeroplane, similar to the exhibit below. Like the airlines, accounting firms have high fixed costs and fixed capacity. When British Airways places a Boeing 777 in service, it adds a certain capacity to its fleet. However, it goes one step further, by dividing up that marginal capacity into four segments (the percentages shown are five suggested capacity allocations for an accounting firm):

A First class (5 to 8%)
B Business class (15 to 24%)
C Full fare coach (30 to 50%)
D Coach/Economy (15 to 35%)
F Leisure and Bereavement fares (10 to 20%)



Your firm has a theoretical *maximum capacity* and a theoretical *optimal capacity* and it is essential to see how that capacity is being allocated to each customer segment. Your maximum capacity is the total number of customers your firm can adequately service (not how many hours you have), while the optimal capacity is the point where customers can be served adequately and crowding out does not affect customer behaviour. Usually, for most service firms, optimal capacity is between 70 and 90 per cent of maximum capacity.

The airlines are adept in managing their adaptive capacity to maximise their revenue and profitability. There are many examples of this strategy in practice. For instance, I looked up a United Airlines flight from San Francisco to London for tomorrow and they are able to accommodate me, either in first-class, business-class, or full-fare coach. The airlines understand it is the last-minute purchaser who values the seat the most and hence they reserve a portion of each plane's capacity for their best customers. They do this even at the risk the plane will take off with some of those high price seats empty – and that revenue can never be recaptured since they cannot inventory seats. Why do they take that risk? Because the rewards of withholding capacity for price insensitive customers comprise the majority of their profits. I was given the option of a first-class ticket on the San Francisco to London (Heathrow) route for $14,417, while business-class was $10,039 and full-fare coach was $2,244. This is not cost-plus pricing, but rather Value Pricing. It does not cost United four to six times more to fly a coach passenger than a first-class or business-class passenger. Rather, they have taken a risk by withholding some of their capacity so I could wait till the last minute to make my booking.

At the other end of the plane, the airlines allocate so many seats to coach, leisure, Priceline.com (or bereavement)-type seats, which

they offer well in advance of the flight. However, no airline *adds* capacity in order to accommodate these customers. And this point is critical, as too many accounting firms will, in fact, add capacity – or reallocate capacity from higher-valued customers – in order to serve low-valued customers.

Furthermore, many firms will turn away high value, last minute work for its best customers because it is operating near maximum capacity, and usually at the low-end of the value curve, for price sensitive customers. This is common during busy seasons, where high value projects will arise from customers, but the firm is at maximum capacity and cannot handle the marginal work. The lost profit opportunities because of this are incalculable.

Many firms worry about running below optimal capacity and cut their prices in order to attract work, especially in the *off* season. This strategy is fine, but you must understand the tradeoff you are making. Usually, that capacity could be better utilised selling more valued services to your first-class and business-class customers. This way, the firm does not cut its price in order to attract price sensitive customers, sending a signal into the marketplace that it is willing to engage in this strategy and negatively affecting the perception of its value proposition. According to most pricing consultants, pricing mistakes are usually the result of mis-allocating capacity to low-value customers due to the fear of not running at optimal (or maximum) capacity.

How much fixed capacity will you allocate to each customer class? What will be the criteria you use to ascertain where in your aeroplane each customer sits? Will you use the Maister personality criteria, or Ric Payne's 12-point criteria, or some mixture of all, as discussed above? One effective idea is to grade your customer base on both an *objective* basis – such as Payne's – and on a *subjective* basis – such as Maister's. Under each method, you will see how your capacity is allocated, forcing you to understand the trade-off you are making between serving various groups of customers. It is possible – indeed likely – you will have a first class customer under one grading method and the same customer would be a bereavement fare under the other grading method. By viewing your firm as an aeroplane with a fixed amount of seats, you will begin to adapt your capacity to those customers who appreciate – and are willing to pay for – your value proposition.

Unlike an aeroplane, however, when a firm is operating under optimal capacity, its human capital need not sit idle. Since professional service firms are intellectual capital intensive, there are a myriad activities team members could perform in below-capacity periods, such as:

- Take time off (as part of an overtime bank, for example)
- Schedule continuing professional education courses
- Catch up on reading, or teach fellow colleagues new knowledge learned from a book or article
- Engage in practice development for the firm
- Cultivate your social capital by engaging in networking
- Spend additional time with your first and business class customers.

All of these activities – and this is in no way a comprehensive list – add to the firm's stock of intellectual capital, which is hardly a waste of its idle capacity.

FIRING CUSTOMERS

What happens when your plane becomes filled with too many C, D and F customers? Many consultants to accounting firms, for instance, estimate the average firm contains between 10 and 40 per cent of F customers. It is never easy, but it is necessary, to remove these customers from your firm. I would suggest removing those customers whose personalities clash with the culture of your firm, or whose characters are in question. Once that is completed, then you can focus on removing other low-valued customers (such as the Cs and Ds). These customers are usually the ones that complain most vociferously about your price and the debilitating effect is that we tend to listen to them the most and this negatively influences how we price our A and B customers. Firing customers is not a one-time event, however, but a continual process. I have observed the most profitable firms religiously cull through their customer base and "outplace" between 5 and 10 per cent of their customers each year.

One caveat: Be sure you have done everything within your power to turn a low value customer into a high value customer. The fact of the matter is *your customers are not going to get better until you do*. Make sure your value proposition is optimised before shedding what may be profitable customers if offered more value.

That said, how should you fire a customer? There are many strategies, some more effective than others. Many firms in the early days of implementing this strategy would simply raise their prices by a factor of two or four and, to their surprise, over half of the customers remained with the firm (a leading indicator of just how much money firms leave on the table). Nevertheless, I strongly advise against this strategy. The goal is to remove the customer, not simply increase their price. Getting two or four times more from an F customer does not make them a C, B or A customer (this is the ethic of the world's oldest profession, not of true professionals).

Another strategy is writing a letter. It is a useful strategy if you are firing a lot of customers at one time but, with a customer you have served for many years, clearly a one-on-one meeting is far preferable. A phone call or a meeting is the best – and most dignified – strategy. You may line up other professionals as potential referral sources (one of your D or F customers could be their A or B customer), or some firms have even sold off these customers to other firms. Here is an example of a possible conversation you may have:

"Mary, we need to talk about how well we're working together. We need to be sure that the range of services we offer matches your needs.

Here in the practice we want to work with people where we can add significant value to their business, rather than just crunching some numbers and filling in some tax returns for them.

This means we are reducing the number of clients we work with and increasing the range of services we provide for them. We're working with them on growing their businesses by offering consultative services. Naturally, this means that our price levels are increasing too. Many of our clients are comfortable with that extra investment because of the value we are giving them in return.

Mary, my gut feeling is that unless I'm very mistaken we simply can't provide you with that value. It seems to me that your needs would be better served by an accountant who just wants to stick to the numbers.

How do you feel about that?"

THE FORCED CHURN

The first item I look at in firms I consult with is the Pareto Analysis – a ranking of all customers from highest to lowest in revenue. Without fail, 20 per cent of the customers generate between 67 and 85 per cent of the revenue. This is the first step in ascertaining how the firm is allocating its fixed capacity to its different customer segments. When I suggest firing between 40 and 80 per cent of customers, there is obviously strong resistance. The most common objection is this would make the firm too dependent on the remaining 20 to 60 per cent. However, given the realities of the Pareto Analysis, your firm is *already* dependent on these customers and by focusing too much capacity on the bottom 40 to 80 per cent, you are actually putting the remaining high value customers at greater risk of defection by ignoring their needs and wants. Many firms have learned that *fewer* customers equates to higher profits, better service, improved team member morale and less complexity in the firm.

That being said, it is difficult to fire that many customers at one time, so I have an alternative strategy. The cable and cellular phone industries track the *churn rate;* that is, lost customers are divided by new customers acquired (you can perform the calculation with both the number of customers and the revenue from the customer). As a way to upgrade your firm's customer base from C, D and F customers, each time a new customer is obtained you would fire somewhere between 1.5 and 4 old customers. Of course, the exact ratio would depend on how many C, D and F customers your firm has and what factor the partners are comfortable with. Not only would this free up capacity to serve the new customers, it would shift the firm up the value curve, allowing your plane to add more full-fare coach, business-class and first-class seats.

The French have a wonderful saying that epitomises this strategy: *Recueillez pour mieux avancer*, which translated means "Fall back, the better to advance." By implementing this strategy gradually, many firms feel more comfortable upgrading their customer base and their sense of security is not jeopardised all at once.

An Important Question

The purpose of your accounting firm is to add to your customers' wealth and well being. By focusing on what customers really buy – expectations – and how important it is to exceed them, you will be well on your way to continuously delivering on that purpose at an increasing rate each day. I discussed how important it was to constantly monitor your customers' expectations, since they are dynamic and not static and subject to ever-increasing standards from any organisation that has the ability to raise them. The value proposition discussed how your firm's price, quality and service come together to create a unique offering for your customer and how your firm must continuously offer a superior alternative in comparison to your competition in order to create customer loyalty.

Since the 1980s the Total Quality Management – and re-engineering – movement arose as a way for firms to increase their quality, moving towards a Six Sigma, or zero defects, standard. The flaws in this strategy for an accounting firm are obvious, since to err is human and rather than focusing on *zero defects*, I proffered a *zero defections* standard, along with an effective customer complaint recovery strategy.

I repeat, the most successful firms in the world today turn away more customers than they accept because they have a rigorous pre-qualifying process and they understand that, ultimately, bad customers drive out good customers. I suggested the metaphor of your firm's fixed capacity as a Boeing 777 aeroplane, in conjunction with the concept of Adaptive Capacity, in order to

You're really not in business to make a profit, but you're in business to render a service that is so good people are willing to pay a profit in recognition of what you're doing for them.

– Stanley Marcus
(1905–2002)

segment your customer base by the value they place on your offerings. I believe the firm of the future is just as diligent in forecasting this capacity – in terms of its yield and load factors – as the airlines are today.

Customers will continue to patronise businesses where they are invited and remain where they are appreciated. Your firm will get the customer behaviour it rewards. Customer loyalty is worth rewarding. Professional services are based on personal relationships. People don't hire firms; they hire individuals within those firms.

Of course, that does not imply that you need to accept all customers, or keep low value customers within your firm. Since you cannot be all things to all people, it is important to work with only those individuals and businesses you enjoy and who have personalities you get along with. In surveys conducted by David Maister, he found accountants spend between 55 per cent and 80 per cent of their time working with people they are either indifferent about, or just don't like. Why do professionals do this? Maister points out:

> Supposedly, professionals are among society's most bright, educated, and elite members – people who are supposed to have more career choices than anyone else. Yet they seem to be willing to accept a work life made up largely of "I can tolerate it" work and clients, and they feel that they cannot safely do anything about all that. (Maister, 1997: 25)

The fact is, you can do something about it, and you do have a choice of whom you work with and whom you accept as a customer. There is no justifiable reason for accepting – or retaining – customers whom you or your team members personally do not like. Toxic customers can have a negative effect on team member morale, and that will ultimately have a deleterious effect on the firm's financial results. If, on the other hand, you work with people you enjoy, not only will you do better work, be a more effective marketer, cross-sell more services, and attract like-kind customers, you will be a better professional and have a better quality of life.

Indeed, you *are* your customer list.

How does that make you feel?

Case Study – O'Byrne and Kennedy LLP

In 1998 we were much like any other small firm of accountants. A ten-person firm in Hertfordshire, eight accountants dealing with the usual mix of work. Accounts and audit of small owner-managed businesses with their tax computations and returns and lots and lots of personal tax returns. We had nearly 500 clients with an average fee of about £1,000.

That average hid a wide spread. As with most client portfolios, there were some stars: clients whose work involved regular contact, sometimes weekly contact and attendance to help with management accounting or particular projects. There was also a large number of very small clients. When the Inland Revenue Self Assessment came in, we believed the market had set the price of a personal tax return at between £100 and £150 and we offered that fixed price accordingly. So for many of our clients, hundreds of them, the fee was £125.

We had come back from The Accountants Boot Camp with their injunctions to stratify clients ringing in our ears. So loud was it ringing, we took a good six months before doing it! We did it first off by gut feel; the two partners went down our respective client lists and gave the client a rating from A (the best) through to D. We discovered we had just 20 A clients, and over 100 D clients! Somehow though, it didn't seem right: we are professionals, and should we even be doing this? And how could we justify our rating unless it was more objective than gut feel? Not that anyone asked to justify it, but we were brought up in an evidence-based profession. So we devised a spreadsheet (of course!) and initially identified five categories that we thought mattered and ended up with a table like this:

Client	Gut score	Calc score	Volume	Speed of payment	Profit	Potential	Like 'em	Partner input
A001	A	B	4	1	4	5	5	3
A002	B	D	3	3	2	2	4	1
C003	A	C	5	2	2	4	4	1
C005	C	B	3	5	4	3	3	4

Readers may ask how we decided to attribute scores, and where to set the thresholds between A, B etc. And how could we score profitability accurately? Well, we didn't know either, so we resolved to just get on and do it as best we could, using proxies where we could, and see what the results told us.

There were many surprises in the results, and we explored where the scoring system gave a different score from the gut feel rating. This led to some adjustments to boundaries and re-ratings. But mostly it led to some valuable insights. The column for "Partner input" was an afterthought, as with most bottles the bottle neck is at the top, and we recognised that how demanding a client is of partner time was a feature of how good the client was for the firm. The scoring system showed us that we had just 1 A client and nearly 200 D's. Not an impressive spread of 500 clients!

So we decided to do something about it and we were determined to sack the lowest of the low D's. Our determination was immediately tested when we were confronted with the fact that many of the lowest were clients for whom the partners had acted for many years, and often had strong personal relationships with the clients and their families – indeed, often were family!

What did we do? Obviously as intelligent, committed professionals we wimped out and invented reasons why we should really keep many of the D's and diverted our attention to sacking the ones we didn't like!

Even this wasn't easy. There seems to be a belief in an unwritten law that whereas clients can sack their accountant as they choose (fair enough) accountants can't ever, ever sack their clients. There is no such law, but nonetheless we found difficulty with actually doing it. There was nothing inherently wrong with these clients; many of them were perfectly good, reasonably well-behaved clients that other firms would be pleased to have. But our new determination to concentrate our efforts on higher value clients meant we had to free up our precious fixed capacity. So we did two things. First, we identified other firms in the area we would be prepared to recommend, so if the clients wanted a recommendation they had some clue who to transfer to.

Second, we worked up a system to break the news and carry through the transition in a professional and reasonable way. We wanted to do it slowly – after all, we wanted to be able to eat!

We drafted a letter to send to clients in effect saying – as one might well have done to a former girl/boyfriend – "It's not you, it's me". We explained that we had chosen to concentrate our efforts in different areas and were not best placed to serve them any longer (whilst giving an opportunity for them to say they wanted more from us). However, we continued, there are many firms that were set up to carry out their type of work and they were free to choose from any of them, and we would be happy to recommend another firm if they would like.

Once we got started, the first 10 per cent of clients went quite quickly. Team morale jumped, the pressure on our filing and storage facilities eased, and the chore of invoicing and collections seemed a little less onerous. Partners' morale soared. We had considered a radical idea – sacking clients – made a choice, faced the difficulties, and implemented it. Not a common feeling in our professional lives! We made the decision initially as much for quality of life as profits. But profits didn't suffer even while we were putting a lot of effort into smoothing the transition of clients out of the firm. And we had time to seek out and welcome in new clients – of the type we wanted.

So we resolved to do more. And more. As we worked up our stratification list, we realised some of the clients we were choosing to dispose of were actually quite good clients. Ones that in the past we would have happily paid to acquire. So we approached other firms (many of whom thought we were mad getting rid of clients) saying: "We've got some good ones, if they want to transfer to you and we make it as easy as could be, what would that be worth to you?" It was worth the going rate for blocks of fees! So we revised our message to the next tranche of clients, telling them that we could recommend other firms, but one in particular we had come to know and we had a close working relationship with. If they transferred to this firm, we would be available to them for any issues they may care to take up with us, have access to our workings, etc, and in consideration of this, the new firm would make some compensation to us.

We got paid for not doing work for clients we didn't want! This cash bonus sped up the re-engineering process in our firm and allowed us to market more to the type of clients we wanted. Our customer list (as we now call it) is under 100 and has an average fee of £6,000.

From that initial stratification of our customer list in 1998, we have taken this further than we ever envisaged and certainly further than you may be thinking of now. Two years after starting this process, we met Ron Baker and he explained, with great passion and logic, the theories of why this was all right and what would happen. Many of the assertions Ron Baker makes in this booklet we have found to be true. I exhort you to test this for yourself (and by all means email me for guidance and support).

You owe it to yourself to take a hard look at your customer list and ask yourself if you would not be better off without some of them? Have you added capacity that is soaked up servicing low-paying (slow-paying?) clients who will never grow into clients of the type you truly want? Have you left room in first class, for when those urgent, price-insensitive, once-in-a-while jobs come along? Have you ever tried to sack a client – it's not so hard as you fear?

If you are an intelligent, trained, professional person with integrity and conscientiousness capable of delivering great value, is that reflected in your customer list?

Paul O'Byrne
O'Byrne and Kennedy LLP
e-mail: noDclients@obk.co.uk
website: www.obk.co.uk/professions

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ACCA UK

29 Lincoln's Inn Fields London WC2A 3EE United Kingdom

tel: +44 (0)141 582 2000 fax: +44 (0)141 582 2222 www.accaglobal.com

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