

PROFITS, CASH FLOW AND EQUITY:

# MANAGING THE MODERN PROFESSIONAL SERVICES FIRM



We help professional services firms to focus on the critical factors for success by providing a comprehensive projection of financial performance and integrating three key elements – profits, cash flow and equity.

This three-way model – profit and loss, balance sheet, and cash flow – allows businesses to effectively plan and monitor their operations by analysing the impact of different scenarios and variables.

By tailoring our three-way forecasting tool to a firm's unique requirements, we can help management gain financial clarity, anticipate challenges, and make strategic decisions to drive success.

## Profits

### Understanding the profitability of your firm

Understanding and optimising profitability is crucial for professional services firms. Our forecasting tool enables firms to assess the current profitability and model certain scenarios based on key drivers. Depending on the industry, these may be revenue pipeline and anticipated growth, people resources and remuneration, margin, and overhead.

Consideration is also given to estimated changes in costs. The forecasts can be tailored to report on the key business reporting structures such as geographic markets, industry sectors, or any other business unit structure. Modelling these drivers forward three to five years provides insights to assist management in making future decisions. We overlay this with our knowledge and experience about what is realistically achievable, providing management with valuable insights for informed decision-making.

A key benefit of having a tailored forecast is that it becomes a management tool when the annual budget is adopted and performance can be measured monthly. Changes in performance are then reflected forward so management can assess performance and consider if any changes are required. We help provide this discipline by working with management to ensure the model is kept up-to-date and maintained as part of their monthly reporting pack.

Our forecasting tool also flows through to an updated current and forecast balance sheet position. This assists with understanding where the profits are – cash/debtors – together with ATO liabilities, net asset position, financing decisions and management of banking requirements into the future.



## Cash flow

### Encouraging firms to 'make it and take it'

Most successful professional service firms are efficient at managing their working capital requirements and distributing any excess profits to their stakeholders. But how much working capital should be employed?

Typically, this will depend on a range of factors – profitability, seasonality, remuneration cycles, investment & banking requirements, tax obligations and profit distribution policies.

Our tailored forecasting tool takes these factors into account on a monthly basis so that management can make timely decisions about managing their firm's working capital across the year.

The tool also accounts for financing commitments, technology investment, equity payouts and equity raising. It incorporates seasonality so buffers can be created – like when businesses wind down for the December/January holiday period.

Any changes in monthly client receipts or debtor days flow through to the forecast so management can make fully informed decisions on areas needing immediate focus and how working capital should be deployed.

Ultimately, after consideration of these factors, management have certainty about the quantum of profits to be distributed to stakeholders and when, providing confidence to stakeholders and future equity participants about their future entitlements.

## Equity

### Making it easier to manage equity participants

Retaining, attracting, and transitioning equity participants will always be challenging in a professional services firm.

Our forecasting tool can be used to illustrate how and when an equity participant can expect to receive their profit entitlements, make equity contributions, and fund retiring equity participants.

This will depend on the firm's structure and model, such as:

- Goodwill vs no goodwill
- Equity vs non-equity
- Tightly held vs growing equity participants
- Company (dividends paid and retention of profits) vs Trust/ Partnership (distribution of profits but not necessarily paid)



## Our experience

### How a firm can fund a move from a goodwill model to a non-goodwill model

We designed and implemented a new ownership model for a national mid-tier firm that set the practice up for future growth by attracting and retaining new Principals. Our forecast modelled the future performance and cash flow of the business under the new ownership model. The forecast:

- Set out a shareholding and funding model that is fluid and equitable, and remunerates Principals based on performance;
- Implemented a “Points System” allocated between Principals that drives distributions of future profit;
- Provided for a funding model that allows existing shareholders to be repaid and transition to Principals under the new structure;
- Demonstrated how payments to shareholders can be funded from available cash; and
- Allowed for the sell-down and retirement of certain shareholders, as well as estimating their cash flows and tax liability.

### Ensuring dividends and fund equity contributions for new equity participants

In a recent engagement, we assisted a growing firm to amalgamate different ownership interests across different business units into a holding company structure. Our forecast modelled the performance of the business assuming this restructure took place, then overlaid an additional stakeholder model that:

- Demonstrated financial benefits from alignment of operations and strategy;
- Provided a mechanism for investment into growth business units;
- Provided a clear pathway and funding model for new equity participants;
- Allowed for staged divestment of equity holdings of

founding shareholders;

- Demonstrated value for both founder and new equity participants; and
- Provided tax efficiency in the restructured ownership model.

### Estimating equity entitlements for the next five years versus raising capital

We recently supported a large national firm through a successful equity sale transaction. Our forecast modelled the potential performance and cash flows of the business looking ahead five years, including:

- Providing a detailed analysis of the business and business units, including forecast by geographic location and by industry sector;
- Providing dynamic scenario analysis of different growth and acquisition assumptions;
- Modelled returns for existing equity holders under sale vs no-sale scenarios;
- Demonstrated value for both buyer and sellers; and
- Established a dashboard for ongoing management reporting.

## How can we help?

Effectively managing a modern professional services firm requires a strategic approach to profits, cash flow, and equity. By integrating these key elements and utilising tailored forecasting tools, businesses can gain financial clarity, anticipate challenges, and make informed decisions.

The forecasting tool provides insights into profitability, allows firms to make timely decisions regarding working capital management, and facilitates management of equity participants. Through detailed analysis and scenario assessment, we provide valuable insights to maximise value and drive growth. By leveraging our expertise, firms can navigate complexities and achieve long-term sustainability in a competitive market.

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With our values at the core, we seek out diverse perspectives and challenge when necessary to deliver positive progress for your business. No matter your industry, business lifecycle stage, market or growth plans, our experienced professionals are dedicated to achieving the best outcome for you and your stakeholders.



## Private Business, Tax & Advisory Capabilities

Our Private Business, Tax & Advisory team works alongside private businesses across Australia – and international players looking to Australia for their investments and operations – on all your tax and accounting needs. From setting up your business and processes and meeting your tax and regulatory obligations, to evolving your structures and strategies, we help you build more optimised financial structures that grow complementary to your business ones.

You are at the core of what we do. That means we tailor our approach to your business, its goals and the focus areas in which you operate.

## Industry Expertise

Grant Thornton’s Professional Services industry team understands the opportunities and issues that your business faces. We understand the pressures of running your business and the steps to reaching your strategic goals. We can help position your business to capitalise on the latest industry trends and innovations and provide expert advice on technology to drive efficiency, the allocation of profits within professional services firms and working capital optimisation.

By working with Grant Thornton, our clients gain access to global expertise and relationships throughout the world

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